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

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**FORM 10-Q**

**(Mark One)**

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

For the quarterly period ended June 30, 2003

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 No. 0-15279

**GENERAL COMMUNICATION, INC.**  
(Exact name of registrant as specified in its charter)

<u>STATE OF ALASKA</u> (State or other jurisdiction of incorporation or organization)	<u>92-0072737</u> (I.R.S. Employer Identification No.)
<u>2550 Denali Street</u> <u>Suite 1000</u> <u>Anchorage, Alaska</u> (Address of principal executive offices)	<u>99503</u> (Zip Code)

Registrant's telephone number, including area code: (907) 265-5600

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Former name, former address and former fiscal year, if changed since last report

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

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

The number of shares outstanding of the registrant's classes of common stock as of July 31, 2003 was:  
52,126,671 shares of Class A common stock; and  
3,870,679 shares of Class B common stock.

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**GENERAL COMMUNICATION, INC.**

**FORM 10-Q**

**FOR THE QUARTER ENDED JUNE 30, 2003**

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## Cautionary Statement Regarding Forward-Looking Statements

You should carefully review the information contained in this Quarterly Report, but should particularly consider any risk factors that we set forth in this Quarterly Report and in other reports or documents that we file from time to time with the Securities and Exchange Commission (“SEC”). In this Quarterly Report, in addition to historical information, we state our future strategies, plans, objectives or goals and our beliefs of future events and of our future operating results, financial position and cash flows. In some cases, you can identify those so-called “forward-looking statements” by words such as “may,” “will,” “should,” “expects,” “plans,” “anticipates,” “believes,” “estimates,” “predicts,” “potential,” “project,” or “continue” or the negative of those words and other comparable words. All forward-looking statements involve known and unknown risks, uncertainties and other important factors that may cause our actual results, performance, achievements, plans and objectives to differ materially from any future results, performance, achievements, plans and objectives expressed or implied by these forward-looking statements. In evaluating those statements, you should specifically consider various factors, including those outlined below. Those factors may cause our actual results to differ materially from any of our forward-looking statements. For these statements, we claim the protection of the safe harbor for forward-looking statements provided by the Securities Reform Act. Such risks, uncertainties and other factors include but are not limited to those identified below and those further described in *Part I, Item 1. Factors That May Affect Our Business and Future Results* of our December 31, 2002 Form 10-K.

- Material adverse changes in the economic conditions in the markets we serve and in general economic conditions, including the continuing impact of the current depressed telecommunications industry due to high levels of competition in the long-distance market resulting in pressures to reduce prices, an oversupply of long-haul capacity, excessive debt loads; several high-profile company failures and potentially fraudulent accounting practices by some companies;
- The efficacy of laws enacted by Congress; rules and regulations to be adopted by the Federal Communications Commission (“FCC”) and state public regulatory agencies to implement the provisions of the 1996 Telecom Act; the outcome of litigation relative thereto; and the impact of regulatory changes relating to access reform;
- Our responses to competitive products, services and pricing, including pricing pressures, technological developments, alternative routing developments, and the ability to offer combined service packages that include long-distance, local, cable and Internet services;
- The extent and pace at which different competitive environments develop for each segment of our business;
- The extent and duration for which competitors from each segment of the telecommunication industries are able to offer combined or full service packages prior to our being able to do so;
- The degree to which we experience material competitive impacts to our traditional service offerings prior to achieving adequate local service entry;
- Competitor responses to our products and services and overall market acceptance of such products and services;
- The outcome of our negotiations with Incumbent Local Exchange Carriers (“ILECs”) and state regulatory arbitrations and approvals with respect to interconnection agreements;
- Our ability to purchase network elements or wholesale services from ILECs at a price sufficient to permit the profitable offering of local telephone service at competitive rates;
- Success and market acceptance for new initiatives, many of which are untested;
- The level and timing of the growth and profitability of existing and new initiatives, particularly local telephone services expansion, Internet services expansion and wireless services;
- Start-up costs associated with entering new markets, including advertising and promotional efforts;
- Risks relating to the operations of new systems and technologies and applications to support new initiatives;

- Local conditions and obstacles;
- The impact on our industry and indirectly on us of oversupply of capacity resulting from excessive deployment of network capacity in certain markets we do not serve;
- Uncertainties inherent in new business strategies, new product launches and development plans, including local telephone services, Internet services, wireless services, digital video services, cable modem services, digital subscriber line services, transmission services, and yellow page directories, and the offering of these services in geographic areas with which we are unfamiliar;
- The risks associated with technological requirements, technology substitution and changes and other technological developments;
- Prolonged service interruptions which could affect our business;
- Development and financing of telecommunication, local telephone, wireless, Internet and cable networks and services;
- Future financial performance, including the availability, terms and deployment of capital; the impact of regulatory and competitive developments on capital outlays, and the ability to achieve cost savings and realize productivity improvements and the consequences of increased leverage;
- Availability of qualified personnel;
- Changes in, or failure, or inability, to comply with, government regulations, including, without limitation, regulations of the FCC, the Regulatory Commission of Alaska (“RCA”), and adverse outcomes from regulatory proceedings;
- Uncertainties in federal military spending levels and military base closures in markets in which we operate;
- The ongoing global and domestic trend towards consolidation in the telecommunications industry, which trend may be the effect of making the competitors larger and better financed and afford these competitors with extensive resources and greater geographic reach, allowing them to compete more effectively;
- The financial, credit and economic impacts of the MCI (previously “WorldCom, Inc.”) bankruptcy filing on the industry in general and on us in particular;
- A conversion of MCI’s bankruptcy petition to Chapter 7, a significant delay in MCI’s emergence from bankruptcy, or a migration of MCI’s traffic off our network without it being replaced by other common carriers that interconnect with our network;
- The effect on us of pricing pressures, new program offerings and market consolidation in the markets served by our major customers, MCI and Sprint;
- Under Statement of Financial Accounting Standard (“SFAS”) 142, we must test our intangibles for impairment at least annually, which may result in a material, non-cash write-down of goodwill and could have a material adverse impact on our results of operations and shareholders’ equity; and
- Other risks detailed from time to time in our periodic reports filed with the SEC.

You should not place undue reliance on any such forward-looking statements. Further, any forward-looking statement, and such risks, uncertainties and other factors speak, only as of the date on which they were originally made and we expressly disclaim any obligation or undertaking to disseminate any updates or revisions to any forward-looking statement to reflect any change in our expectations with regard to those statements or any other change in events, conditions or circumstances on which any such statement is based, except as required by law. New factors emerge from time to time, and it is not possible for us to predict what factors will arise or when. In addition, we cannot assess the impact of each factor on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements.

**PART I. FINANCIAL INFORMATION**  
**ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS**

**GENERAL COMMUNICATION, INC. AND SUBSIDIARIES**

**CONSOLIDATED BALANCE SHEETS**

(Amounts in thousands)	(Unaudited)	
ASSETS	June 30, 2003	December 31, 2002
Current assets:		
Cash and cash equivalents	\$ 17,977	11,940
Receivables:		
Trade	70,549	63,111
Employee	320	391
Other	2,621	3,093
	<u>73,490</u>	<u>66,595</u>
Less allowance for doubtful receivables	13,522	14,010
Net receivables	<u>59,968</u>	<u>52,585</u>
Prepaid and other current assets	9,938	9,171
Deferred income taxes, net	8,829	8,509
Notes receivable with related parties	1,059	697
Property held for sale	1,037	1,037
Inventories	408	400
Total current assets	<u>99,216</u>	<u>84,339</u>
Property and equipment in service, net of depreciation	376,838	381,394
Construction in progress	13,530	16,958
Net property and equipment	<u>390,368</u>	<u>398,352</u>
Cable certificates, net of amortization of \$26,775 and \$26,884 at June 30, 2003 and December 31, 2002, respectively	191,241	191,132
Goodwill, net of amortization of \$7,200 at June 30, 2003 and December 31, 2002	41,972	41,972
Other intangible assets, net of amortization of \$1,327 and \$1,848 at June 30, 2003 and December 31, 2002, respectively	3,393	3,460
Deferred loan and senior notes costs, net of amortization of \$5,999 and \$4,110 at June 30, 2003 and December 31, 2002, respectively	10,838	9,961
Notes receivable with related parties	5,060	5,142
Other assets, at cost, net of amortization of \$39 and \$24 at June 30, 2003 and December 31, 2002, respectively	5,282	4,424
Total other assets	<u>257,786</u>	<u>256,091</u>
Total assets	<u>\$ 747,370</u>	<u>738,782</u>

See accompanying notes to interim condensed consolidated financial statements.

**GENERAL COMMUNICATION, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
**(Continued)**

(Amounts in thousands)	(Unaudited)	
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>	June 30, 2003	December 31, 2002
Current liabilities:		
Current maturities of obligations under long-term debt and capital leases	\$ 22,900	1,857
Accounts payable	29,227	33,605
Deferred revenue	18,094	18,290
Accrued payroll and payroll related obligations	13,933	11,821
Accrued interest	8,000	7,938
Accrued liabilities	5,987	5,763
Subscriber deposits	758	889
Total current liabilities	98,899	80,163
Long-term debt, excluding current maturities	335,000	357,700
Obligations under capital leases, excluding current maturities	42,094	44,072
Obligations under capital leases due to related party, excluding current maturities	691	703
Deferred income taxes, net of deferred income tax benefit	21,902	16,061
Other liabilities	6,807	4,956
Total liabilities	505,393	503,655
Redeemable preferred stocks	26,907	26,907
Stockholders' equity:		
Common stock (no par):		
Class A. Authorized 100,000 shares; issued 52,112 and 51,795 shares at June 30, 2003 and December 31, 2002, respectively	200,149	199,903
Class B. Authorized 10,000 shares; issued 3,874 and 3,875 shares at June 30, 2003 and December 31, 2002, respectively; convertible on a share-per-share basis into Class A common stock	3,273	3,274
Less cost of 338 and 317 Class A common shares held in treasury at June 30, 2003 and December 31, 2002, respectively	(1,917)	(1,836)
Paid-in capital	11,554	11,222
Notes receivable with related parties issued upon stock option exercise	(5,650)	(5,650)
Retained earnings	8,188	1,847
Accumulated other comprehensive loss	(527)	(540)
Total stockholders' equity	215,070	208,220
Commitments and contingencies		
Total liabilities and stockholders' equity	\$ 747,370	738,782

See accompanying notes to interim condensed consolidated financial statements.

**GENERAL COMMUNICATION, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(Unaudited)**

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
(Amounts in thousands, except per share amounts)				
Revenues	\$ 95,939	92,740	188,716	180,950
Cost of sales and services	30,071	30,861	60,319	62,098
Selling, general and administrative expenses	34,294	32,585	67,287	63,886
Bad debt expense	802	10,616	1,399	11,197
Depreciation, amortization and accretion expense	12,800	13,912	26,301	27,870
Operating income	17,972	4,766	33,410	15,899
Other income (expense):				
Interest expense	(9,138)	(6,236)	(18,292)	(12,827)
Amortization of loan and senior notes fees	(625)	(371)	(1,698)	(1,128)
Interest income	165	155	331	228
Other expense, net	(9,598)	(6,452)	(19,659)	(13,727)
Net income (loss) before income taxes and cumulative effect of a change in accounting principle	8,374	(1,686)	13,751	2,172
Income tax (expense) benefit	(3,564)	583	(5,846)	(1,063)
Net income (loss) before cumulative effect of a change in accounting principle	4,810	(1,103)	7,905	1,109
Cumulative effect of a change in accounting principle, net of income tax benefit of \$367	---	---	(544)	---
Net income (loss)	\$ 4,810	(1,103)	7,361	1,109
Basic and diluted net income (loss) per common share:				
Net income (loss) before cumulative effect of a change in accounting principle	\$ 0.08	(0.03)	0.12	0.00
Cumulative effect of a change in accounting principle, net of income tax benefit of \$367	---	---	(0.01)	---
Net income (loss)	\$ 0.08	(0.03)	0.11	0.00

See accompanying notes to interim condensed consolidated financial statements.

**GENERAL COMMUNICATION, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
**SIX MONTHS ENDED JUNE 30, 2003 AND 2002**  
**(Unaudited)**

(Amounts in thousands)	Class A Common Stock	Class B Common Stock	Class A Shares Held in Treasury	Paid-in Capital	Notes Receivable Issued to Related Parties	Retained Earnings (Deficit)	Accumulated Other Comprehensive Income (Loss)	Total
Balances at December 31, 2001	\$195,647	3,281	(1,659)	10,474	(2,588)	(2,771)	8	202,392
Components of comprehensive income:								
Net income	---	---	---	---	---	1,109	---	1,109
Change in fair value of cash flow hedge, net of change in income tax liability of \$151	---	---	---	---	---	---	(232)	(232)
Comprehensive income								877
Tax effect of excess stock compensation expense for tax purposes over amounts recognized for financial reporting purposes	---	---	---	307	---	---	---	307
Class B shares converted to Class A	2	(2)	---	---	---	---	---	---
Shares issued under stock option plan	3,166	---	---	---	(3,062)	---	---	104
Amortization of the excess of GCI stock market value over stock option exercise cost on date of stock option grant	---	---	---	238	---	---	---	238
Purchase of treasury stock	---	---	(177)	---	---	---	---	(177)
Preferred stock dividends	---	---	---	---	---	(1,019)	---	(1,019)
Balances at June 30, 2002	\$198,815	3,279	(1,836)	11,019	(5,650)	(2,681)	(224)	202,722
Balances at December 31, 2002	\$199,903	3,274	(1,836)	11,222	(5,650)	1,847	(540)	208,220
Components of comprehensive income:								
Net income	---	---	---	---	---	7,361	---	7,361
Change in fair value of cash flow hedge, net of change in income tax benefit of \$105	---	---	---	---	---	---	13	13
Comprehensive income								7,374
Tax effect of excess stock compensation expense for tax purposes over amounts recognized for financial reporting purposes	---	---	---	63	---	---	---	63
Class B shares converted to Class A	1	(1)	---	---	---	---	---	---
Shares issued under stock option plan	245	---	---	---	---	---	---	245
Amortization of the excess of GCI stock market value over stock option exercise cost on date of stock option grant	---	---	---	269	---	---	---	269
Purchase of treasury stock	---	---	(81)	---	---	---	---	(81)
Preferred stock dividends	---	---	---	---	---	(1,020)	---	(1,020)
Balances at June 30, 2003	\$200,149	3,273	(1,917)	11,554	(5,650)	8,188	(527)	215,070

See accompanying notes to interim condensed consolidated financial statements.

**GENERAL COMMUNICATION, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	(Unaudited) Six Months Ended June 30,	
	2003	2002
(Amounts in thousands)		
Operating activities:		
Net income	\$ 7,361	1,109
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, amortization and accretion expense	26,301	27,870
Deferred income tax expense	5,846	1,158
Amortization of loan and senior notes fees	1,698	1,128
Cumulative effect of a change in accounting principle, net of income tax benefit of \$367	544	---
Bad debt expense, net of write-offs	(488)	9,713
Deferred compensation and compensatory stock options	567	634
Other noncash income and expense items	(254)	18
Change in operating assets and liabilities	(9,935)	(11,705)
Net cash provided by operating activities	31,640	29,925
Investing activities:		
Purchases of property and equipment	(17,375)	(36,192)
Payment of deposit	(721)	---
Notes receivable issued to related parties	(48)	(3,055)
Payments received on notes receivable with related parties	22	858
Purchases of other assets	(403)	(940)
Net cash used by investing activities	(18,525)	(39,329)
Financing activities:		
Repayments of long-term borrowings and capital lease obligations	(3,647)	(395)
Long-term borrowings – bank debt	---	9,000
Payment of preferred stock dividend	(1,020)	(1,018)
Payment of debt issuance costs	(2,575)	(250)
Purchase of treasury stock	(81)	(177)
Proceeds from common stock issuance	245	104
Net cash provided (used) by financing activities	(7,078)	7,264
Net increase (decrease) in cash and cash equivalents	6,037	(2,140)
Cash and cash equivalents at beginning of period	11,940	11,097
Cash and cash equivalents at end of period	\$ 17,977	8,957

See accompanying notes to interim condensed consolidated financial statements.

**GENERAL COMMUNICATION, INC. AND SUBSIDIARIES**  
**Notes to Interim Condensed Consolidated Financial Statements**  
(Unaudited)

The accompanying unaudited interim condensed consolidated financial statements include the accounts of General Communication, Inc. (“GCI”) and its subsidiaries and have been prepared in accordance with generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. They should be read in conjunction with our audited consolidated financial statements for the year ended December 31, 2002, filed as part of our annual report on Form 10-K. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for interim periods are not necessarily indicative of the results that may be expected for an entire year or any other period.

(l) **Business and Summary of Significant Accounting Principles**

In the following discussion GCI and its direct and indirect subsidiaries are referred to as “we,” “us” and “our”.

(a) Business

GCI, an Alaska corporation, was incorporated in 1979. We offer the following services:

- Long-distance telephone service between Anchorage, Fairbanks, Juneau, and other communities in Alaska and the remaining United States and foreign countries
- Cable television services throughout Alaska
- Facilities-based competitive local access services in Anchorage, Fairbanks and Juneau, Alaska
- Internet access services
- Termination of traffic in Alaska for certain common carriers
- Private line and private network services
- Managed services to certain commercial customers
- Broadband services, including our SchoolAccess™ offering to rural school districts and a similar offering to rural hospitals and health clinics
- Sales and service of dedicated communications systems and related equipment
- Lease and sales of capacity on two undersea fiber optic cables used in the transmission of interstate and intrastate private line, switched message long-distance and Internet services between Alaska and the remaining United States and foreign countries

(b) Principles of Consolidation

The consolidated financial statements include the accounts of GCI, GCI’s subsidiary GCI, Inc., GCI, Inc.’s subsidiary GCI Holdings, Inc., GCI Holdings, Inc.’s subsidiaries GCI Communication Corp., GCI Cable, Inc., GCI Transport Co., Inc., GCI Fiber Communication Co., Inc., GCI Fiber Co., Inc. and Fiber Hold Co., Inc. and GCI Fiber Co., Inc.’s and Fiber Hold Co., Inc.’s partnership Alaska United Fiber System Partnership, GCI Communication Corp.’s subsidiaries Potter View Development Co., Inc., Wok 1, Inc. and Wok 2, Inc. and GCI Transport Co., Inc.’s subsidiary GCI Satellite Co., Inc. All subsidiaries are wholly-owned at June 30, 2003.

The consolidated financial statements include the consolidated accounts of GCI and its wholly owned subsidiaries with all significant intercompany transactions eliminated.

**GENERAL COMMUNICATION, INC. AND SUBSIDIARIES**  
**Notes to Interim Condensed Consolidated Financial Statements**  
(Unaudited)

(c) Earnings per Common Share

Earnings per common share ("EPS") and common shares used to calculate basic and diluted EPS consist of the following (amounts in thousands, except per share amounts):

	Three Months Ended June 30,					
	2003			2002		
	Income	Shares	Per-share	Loss	Shares	Per-share
	(Num-erator)	(Denom-inator)	Amounts	(Num-erator)	(Denom-inator)	Amounts
Net income (loss)	\$ 4,810			\$ (1,103)		
Less preferred stock dividends:						
Series B	361			361		
Series C	150			150		
<b>Basic EPS:</b>						
Net income (loss) available to common stockholders	4,299	55,613	\$ 0.08	(1,614)	55,040	\$ (0.03)
<b>Effect of Dilutive Securities:</b>						
Unexercised stock options	---	354	---	---	---	---
<b>Diluted EPS:</b>						
Net income (loss) available to common stockholders	\$ 4,299	55,967	\$ 0.08	\$ (1,614)	55,040	\$ (0.03)

**GENERAL COMMUNICATION, INC. AND SUBSIDIARIES**  
**Notes to Interim Condensed Consolidated Financial Statements**  
(Unaudited)

	Six Months Ended June 30,					
	2003			2002		
	Income (Num- erator)	Shares (Denom- inator)	Per-share Amounts	Income (Num- erator)	Shares (Denom- inator)	Per-share Amounts
Net income before cumulative effect of a change in accounting principle, net of deferred tax benefit of \$367	\$ 7,905			\$ 1,109		
Less preferred stock dividends:						
Series B	722			721		
Series C	298			298		
<b>Basic EPS:</b>						
Net income before cumulative effect of a change in accounting principle, net of deferred tax benefit of \$367, available to common stockholders	6,885	55,489	\$ 0.12	90	54,956	\$ 0.00
<b>Effect of Dilutive Securities:</b>						
Unexercised stock options	---	323	---	---	1,058	---
<b>Diluted EPS:</b>						
Net income before cumulative effect of a change in accounting principle, net of deferred tax benefit of \$367, available to common stockholders	\$ 6,885	55,812	\$ 0.12	\$ 90	56,014	\$ 0.00

Common equivalent shares outstanding which are anti-dilutive for purposes of calculating EPS for the three and six months ended June 30, 2003 and 2002, are not included in the diluted EPS calculations, and consist of the following for the three and six months ended June 30, 2003 and 2002 (shares, in thousands):

Series B redeemable preferred stock	3,062
Series C redeemable preferred stock	833
Anti-dilutive common equivalent shares outstanding	3,895

**GENERAL COMMUNICATION, INC. AND SUBSIDIARIES**  
**Notes to Interim Condensed Consolidated Financial Statements**  
(Unaudited)

Weighted average shares associated with outstanding stock options for the three and six months ended June 30, 2003 and 2002 which have been excluded from the diluted EPS calculations because the options' exercise price was greater than the average market price of the common shares consist of the following (shares, in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Weighted average shares associated with outstanding stock options	4,775	131	4,653	135

(d) Common Stock

Following is the statement of common stock at June 30, 2003 and 2002 (shares, in thousands):

	Class A	Class B
Balances at December 31, 2001	50,967	3,883
Class B shares converted to Class A	6	(6)
Shares issued under stock option plan	533	---
Balances at June 30, 2002	51,506	3,877
Balances at December 31, 2002	51,795	3,875
Class B shares converted to Class A	1	(1)
Shares issued under stock option plan	93	---
Shares issued per G.C. Cablevision, Inc. acquisition agreement	223	---
Balances at June 30, 2003	52,112	3,874

(e) Redeemable Preferred Stocks

Redeemable preferred stocks at June 30, 2003 and 2002 consist of (amounts in thousands):

Series B	\$ 16,907
Series C	10,000
	\$ 26,907

We have 1,000,000 shares of preferred stock authorized with the following shares issued (in thousands):

	Series B	Series C
Shares at December 31, 2001 and 2002 and June 30, 2002 and 2003	17	10

**GENERAL COMMUNICATION, INC. AND SUBSIDIARIES**  
**Notes to Interim Condensed Consolidated Financial Statements**  
(Unaudited)

As of June 30, 2003, the combined aggregate amount of preferred stock mandatory redemption requirements follow (amounts in thousands):

Years ending June 30:	
2004	\$ ---
2005	10,150
2006	---
2007	---
2008	---
	<u>\$ 10,150</u>

Series B

The redemption amount of our convertible redeemable accreting Series B preferred stock at June 30, 2003 and December 31, 2002 was \$17,148,000. The difference between the carrying and redemption amounts is due to accrued dividends which are included in Accrued Liabilities.

Series C

The redemption amount of our convertible redeemable accreting Series C preferred stock on June 30, 2003 and December 31, 2002 was \$10,000,000.

(f) Asset Retirement Obligations

On January 1, 2003 we adopted SFAS No. 143, "Accounting for Asset Retirement Obligations". SFAS No. 143 provides accounting and reporting standards for costs associated with the retirement of long-lived assets. This statement requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes a cost by increasing the carrying amount of the related long-lived asset. 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, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. Upon adoption, we recorded the cumulative effect of accretion and depreciation expense as a cumulative effect of a change in accounting principle of approximately \$544,000, net of income tax benefit of \$367,000.

Following is a reconciliation of the beginning and ending aggregate carrying amount of our asset retirement obligations at June 30, 2003 (amounts in thousands):

Balance at December 31, 2002	\$ ---
Liability recognized upon adoption of SFAS No. 143	1,565
Accretion expense for the six months ended June 30, 2003	<u>64</u>
Balance at June 30, 2003	<u>\$ 1,629</u>

Following is the amount of the liability for asset retirement obligations as if SFAS No. 143 had been applied at December 31, 2001 (amounts in thousands):

Balance at December 31, 2001	<u>\$ 1,350</u>
Balance at June 30, 2002	<u>\$ 1,457</u>
Balance at June 30, 2003	<u>\$ 1,629</u>

**GENERAL COMMUNICATION, INC. AND SUBSIDIARIES**  
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(g) Payments Received from Suppliers

On March 20, 2003 the Financial Accounting Standards Board issued Emerging Issues Task Force (“EITF”) Issue No. 02-16, “Accounting by a Reseller for Cash Consideration Received from a Vendor” (“EITF No. 02-16”). We have applied EITF No. 02-16 prospectively for arrangements entered into or modified after December 31, 2002. Our cable services segment occasionally receives reimbursements for costs to promote suppliers’ services, called cooperative advertising arrangements. The supplier payment is classified as a reduction of selling, general and administrative expenses if it reimburses specific, incremental and identifiable costs incurred to resell the suppliers’ services. Excess consideration, if any, is classified as a reduction of cost of sales and services.

Occasionally our cable services segment enters into a binding arrangement with a supplier in which we receive a rebate dependent upon us meeting a specified goal. We recognize the rebate as a reduction of cost of sales and services systematically as we make progress toward the specified goal, provided the amounts are probable and reasonably estimable. If earning the rebate is not probable and reasonably estimable, it is recognized only when the goal is met.

(h) Costs Associated with Exit or Disposal Activities

On January 1, 2003 we adopted SFAS No. 146, “Accounting for Costs Associated with Exit or Disposal Activities”. Upon adoption of SFAS No. 146, enterprises may only record exit or disposal costs when they are incurred and can be measured at fair value. The recorded liability will be subsequently adjusted for changes in estimated cash flows. SFAS 146 revises accounting for specified employee and contract terminations that are part of restructuring activities. Adoption of SFAS No. 146 did not have a material effect on our results of operations, financial position and cash flows.

(i) Stock Option Plan

At June 30, 2003, we had one stock-based employee compensation plan. We account for this plan under the recognition and measurement principles of Accounting Principles Board (“APB”) Opinion No. 25, “Accounting for Stock Issued to Employees,” and related interpretations. We use the intrinsic-value method and compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeds the exercise price. We have adopted SFAS No. 123, “Accounting for Stock-Based Compensation,” which permits entities to recognize as expense over the vesting period the fair value of all stock-based awards on the date of grant. Alternatively, SFAS No. 123 also allows entities to continue to apply the provisions of APB Opinion No. 25.

We have adopted SFAS No. 148, “Accounting for Stock-Based Compensation-Transition and Disclosure”. This Statement amends SFAS No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. We have elected to continue to apply the provisions of APB Opinion No. 25 and provide the pro forma disclosure as required by SFAS No. 148.

Stock-based employee compensation cost is reflected over the options’ vesting period of generally five years and compensation cost for options granted prior to January 1, 1996 is not considered. The following table illustrates the effect on net income (loss) and EPS for the three and six months ended June 30, 2003 and 2002, if we had applied the fair-value recognition

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provisions of SFAS No. 123 to stock-based employee compensation (amounts in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2003	2002	2003	2002
Net income (loss), as reported	\$ 4,810	(1,103)	7,361	1,109
Total stock-based employee compensation expense included in reported net income, net of related tax effects	91	83	159	142
Total stock-based employee compensation expense under the fair-value based method for all awards, net of related tax effects	(451)	(488)	(925)	(1,063)
Pro forma net income (loss)	<u>\$ 4,450</u>	<u>(1,508)</u>	<u>6,595</u>	<u>188</u>
Basic and diluted net income (loss) per common share after cumulative effect of a change in accounting principle, as reported	<u>\$ 0.08</u>	<u>(0.03)</u>	<u>0.11</u>	<u>0.00</u>
Basic and diluted net income (loss) per common share after cumulative effect of a change in accounting principle, pro forma	<u>\$ 0.07</u>	<u>(0.04)</u>	<u>0.10</u>	<u>(0.02)</u>

The calculation of total stock-based employee compensation expense under the fair-value based method includes weighted-average assumptions of a risk-free interest rate, volatility and an expected life.

(j) Concentrations of Credit Risk

Financial instruments that potentially subject us to concentrations of credit risk are primarily cash and cash equivalents and accounts receivable. Excess cash is invested in high quality short-term liquid money instruments issued by highly rated financial institutions. At June 30, 2003 and December 31, 2002, substantially all of our cash and cash equivalents were invested in short-term liquid money instruments at one highly rated financial institution.

We have two major customers, MCI and Sprint Corporation. There is increased risk associated with these customers' accounts receivable balances. Our remaining customers are located primarily throughout Alaska. Because of this geographic concentration, our growth and operations depend upon economic conditions in Alaska. The economy of Alaska is dependent upon the natural resources industries, and in particular oil production, as well as tourism, government, and United States military spending. Though limited to one geographical area and except for MCI and Sprint, the concentration of credit risk with respect to our receivables is minimized due to the large number of customers, individually small balances, and short payment terms.

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(k) Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others

On January 1, 2003 we adopted FASB Interpretation ("FIN") No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others". This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. This Interpretation does not prescribe a specific approach for subsequently measuring the guarantor's recognized liability over the term of the related guarantee. This Interpretation also incorporates, without change, the guidance in FIN No. 34, "Disclosure of Indirect Guarantees of Indebtedness of Others", which is being superseded. Adoption of FIN No. 45 did not have a material effect on our results of operations, financial position and cash flows.

(l) Reclassifications

Reclassifications have been made to the 2002 financial statements to make them comparable with the 2003 presentation.

(2) Consolidated Statements of Cash Flows Supplemental Disclosures

Changes in operating assets and liabilities consist of (amounts in thousands):

Six month periods ended June 30,	<u>2003</u>	<u>2002</u>
Increase in accounts receivable	\$ (6,894)	(7,819)
Increase in inventories	(8)	(820)
(Increase) decrease in prepaid and other current assets	(767)	455
Decrease in accounts payable	(4,379)	(1,124)
Decrease in deferred revenues	(196)	(162)
Increase (decrease) in accrued payroll and payroll related obligations	2,112	(4,783)
Increase in accrued interest	62	196
Increase in accrued liabilities	224	1,258
Increase (decrease) in subscriber deposits	(130)	202
Increase in components of other long-term liabilities	41	892
	<u>\$ (9,935)</u>	<u>(11,705)</u>

We paid interest totaling approximately \$18,230,000 and \$12,631,000 during the six months ended June 30, 2003 and 2002, respectively.

Effective March 31, 2001 we acquired the assets and customer base of G.C. Cablevision, Inc. Upon acquisition the seller received shares of GCI Class A common stock with a future payment in additional shares contingent upon the market price of our common stock on March 31, 2003. At March 31, 2003 the market price condition was not met and approximately 222,600 shares of GCI Class A common stock were issued.

(3) Intangible Assets

Cable certificates are allocated to our cable services segment. Goodwill is primarily allocated to the cable services segment and the remaining amount is not allocated to a reportable segment, but is included in the All Other category in note 5.

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Amortization expense for amortizable intangible assets was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Amortization expense	\$ 132	181	332	387

Amortization expense for amortizable intangible assets for each of the five succeeding fiscal years is estimated to be (amounts in thousands):

Years ending December 31,	
2003	\$ 526
2004	\$ 470
2005	\$ 338
2006	\$ 334
2007	\$ 273

No intangible assets have been impaired based upon impairment testing performed as of December 31, 2002 and no indicators of impairment have occurred since the impairment testing was performed.

(4) Long-term Debt

On April 22, 2003 we amended our \$225.0 million Senior Facility. The amendment provides for the followings changes:

- The final maturity date has been extended to October 31, 2007,
- We may fund capital expenditures, including construction or acquisition of additional fiber optic cable system capacity, through our own cash flow or by draws on the revolving credit facility of the Senior Facility not to exceed \$25.0 million, and
- The definition of Excess Cash Flow has been changed to the amount by which earnings before interest, taxes, depreciation, and amortization exceeds certain fixed charges as defined in the Senior Facility agreement plus one-time fiber sales to the extent such fiber sales are not included in earnings before interest, taxes, depreciation, and amortization,

The amendment requires us to prepay the term loan as follows (amounts in thousands):

Date	Amount
Quarterly from September 30, 2003 to December 31, 2004	\$ 5,000
Quarterly from March 31, 2005 to December 31, 2005	\$ 6,000
Quarterly from March 31, 2006 to December 31, 2006	\$ 8,000
Quarterly from March 31, 2007 to September 30, 2007	\$ 10,000

The remaining balance of the term loan will be payable in full on October 31, 2007.

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Under the amended Senior Facility capital expenditures, other than those incurred to build or acquire additional fiber optic cable system capacity, in any of the years ended December 31, 2003, 2004, 2005 and 2006 may not exceed:

- \$25.0 million, plus
- 100% of any Excess Cash Flow during the applicable period less certain permitted investments of up to \$5.0 million during the applicable period.

Under the amended Senior Facility we must either have repaid in full or successfully refinanced our Senior Notes by February 1, 2007.

In connection with the amendment of the Senior Facility, we paid bank fees and other expenses of approximately \$2,379,000 during the six months ended June 30, 2003 which will be amortized over the life of the amended agreement.

(5) Industry Segments Data

Our reportable segments are business units that offer different products. The reportable segments are each managed separately and offer distinct products with different production and delivery processes.

We have four reportable segments as follows:

Long-distance services. We offer a full range of common carrier long-distance services to commercial, government, other telecommunications companies and residential customers, through our networks of fiber optic cables, digital microwave, and fixed and transportable satellite earth stations and our SchoolAccess™ offering to rural school districts and a similar offering to rural hospitals and health clinics.

Cable services. We provide cable television services to residential, commercial and government users in the State of Alaska. Our cable systems serve 33 communities and areas in Alaska, including the state's four largest urban areas, Anchorage, Fairbanks, the Matanuska-Susitna Valley and Juneau. We offer digital cable television services in Anchorage, the Matanuska-Susitna Valley, Fairbanks, Juneau, Kenai and Soldotna and retail cable modem service (through our Internet services segment) in all of our locations in Alaska except Kotzebue. We plan to continue to expand our product offerings as plant upgrades are completed in other communities in Alaska.

Local access services. We offer facilities based competitive local exchange services in Anchorage, Fairbanks and Juneau and plan to provide similar competitive local exchange services in other locations pending regulatory approval and subject to availability of capital.

Internet services. We offer wholesale and retail Internet services to both consumer and commercial customers. We offer cable modem service as further described under Cable services above. Our undersea fiber optic cable allows us to offer enhanced services with high-bandwidth requirements.

Included in the "All Other" category in the tables that follow are our managed services, product sales and cellular telephone services. None of these business units has ever met the quantitative thresholds for determining reportable segments. Also included in the All Other category are corporate related expenses including information technology, accounting, legal and regulatory, human resources and other general and administrative expenses. Operating expenses for the preparation of our new phone directory are included in the All Other category. The revenue and costs of sales and service for our new phone directory will be included in the All Other category upon their recognition.

**GENERAL COMMUNICATION, INC. AND SUBSIDIARIES**  
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We evaluate performance and allocate resources based on (1) earnings or loss from operations before depreciation, amortization and accretion expense, net other expense and income taxes, and (2) operating income or loss. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies in note 1. Intersegment sales are recorded at cost plus an agreed upon intercompany profit.

We earn all revenues through sales of services and products within the United States of America. All of our long-lived assets are located within the United States of America, except approximately 72% of our undersea fiber optic cable system which transits international waters.

Summarized financial information for our reportable segments for the six months ended June 30, 2003 and 2002 follows (amounts in thousands):

	Reportable Segments						Total
	Long-Distance Services	Cable Services	Local Access Services	Internet Services	Total Reportable Segments	All Other	
<u>2003</u>							
Revenues:							
Intersegment	\$ 7,251	1,258	5,015	6,382	19,906	372	20,278
External	100,056	47,310	17,671	9,380	174,417	14,299	188,716
Total revenues	<u>\$107,307</u>	<u>48,568</u>	<u>22,686</u>	<u>15,762</u>	<u>194,323</u>	<u>14,671</u>	<u>208,994</u>
Earnings (loss) from operations before depreciation, amortization, net interest expense and income taxes	\$ 53,239	22,806	1,607	1,339	78,991	(18,049)	60,942
Operating income (loss)	<u>\$ 43,482</u>	<u>13,744</u>	<u>(129)</u>	<u>(361)</u>	<u>56,736</u>	<u>(22,095)</u>	<u>34,641</u>
<u>2002</u>							
Revenues:							
Intersegment	\$ 10,847	1,017	5,490	4,548	21,902	372	22,274
External	102,442	43,265	15,414	7,485	168,606	12,344	180,950
Total revenues	<u>\$113,289</u>	<u>44,282</u>	<u>20,904</u>	<u>12,033</u>	<u>190,508</u>	<u>12,716</u>	<u>203,224</u>
Earnings (loss) from operations before depreciation, amortization, net interest expense and income taxes	\$ 43,212	20,351	2,127	(5,658)	60,032	(15,806)	44,226
Operating income (loss)	<u>\$ 30,953</u>	<u>12,085</u>	<u>459</u>	<u>(7,432)</u>	<u>36,065</u>	<u>(19,709)</u>	<u>16,356</u>

**GENERAL COMMUNICATION, INC. AND SUBSIDIARIES**  
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A reconciliation of reportable segment revenues to consolidated revenues follows (amounts in thousands):

Six months ended June 30,	2003	2002
Reportable segment revenues	\$ 194,323	190,508
Plus All Other revenues	14,671	12,716
Less intersegment revenues eliminated in consolidation	20,278	22,274
Consolidated revenues	\$ 188,716	180,950

A reconciliation of reportable segment earnings from operations before depreciation, amortization and accretion expense, net other expense and income taxes to consolidated net income before income taxes and cumulative effect of a change in accounting principle follows (amounts in thousands):

Six months ended June 30,	2003	2002
Reportable segment earnings from operations before depreciation, amortization and accretion expense, net other expense and income taxes	\$ 78,991	60,032
Less All Other loss from operations before depreciation, amortization and accretion expense, net other expense and income taxes	18,049	15,806
Less intersegment contribution eliminated in consolidation	1,231	457
Consolidated earnings from operations before depreciation, amortization and accretion expense, net other expense and income taxes	59,711	43,769
Less depreciation, amortization and accretion expense	26,301	27,870
Consolidated operating income	33,410	15,899
Less other expense, net	19,659	13,727
Consolidated net income before income taxes and cumulative effect of a change in accounting principle	\$ 13,751	2,172

A reconciliation of reportable segment operating income to consolidated net income before income taxes and cumulative effect of a change in accounting principle follows (amounts in thousands):

Six months ended June 30,	2003	2002
Reportable segment operating income	\$ 56,736	36,065
Less All Other operating loss	22,095	19,709
Less intersegment contribution eliminated in consolidation	1,231	457
Consolidated operating income	33,410	15,899
Less other expense, net	19,659	13,727
Consolidated net income before income taxes and cumulative effect of a change in accounting principle	\$ 13,751	2,172

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(6) Commitments and Contingencies

Litigation and Disputes

We are routinely involved in various lawsuits, billing disputes, legal proceedings and regulatory matters that have arisen in the normal course of business.

On July 1, 1999, the Alaska Public Utilities Commission (“APUC”) ruled that the rural exemptions from local competition for the ILECs operating in Juneau, Fairbanks and North Pole would not be continued, which allowed us to negotiate for unbundled elements for the provision of competitive local service. Alaska Communications Systems, Inc. (“ACS”) requested reconsideration of this decision and on October 11, 1999, the RCA issued an order terminating rural exemptions for the ILECs operating in the Fairbanks and Juneau markets. ACS has appealed these decisions. The appeal presently is before the Alaska Supreme Court. On February 11, 2003, the Alaska Supreme Court heard oral argument. One of the principal issues in dispute concerns the assignment of the burden of proof. In accordance with instructions from the Alaska Superior Court, the APUC assigned the burden to ACS at the remand proceeding. At the oral argument, several Justices expressed concern with the assignment of the burden. At this time, we cannot reasonably predict what the outcome of the case will be or even what relief the Court might order if it were to find that the burden of proof was improperly assigned to ACS. An adverse decision from the Court, however, has the potential to disrupt our ability to provide service to our Fairbanks and Juneau customers over our facilities. We are unable to predict when the Court will issue their decision.

While the ultimate results of these items cannot be predicted with certainty, we do not expect at this time the resolution of them, except for the rural exemption proceedings described above, to have a material adverse effect on our financial position, results of operations or liquidity.

Fiber Optic Cable System Construction Commitment

In June 2003 we began work on the construction of a fiber optic cable system connecting Seward, Alaska and Warrenton, Oregon, with leased backhaul facilities to connect it to our switching and distribution centers in Anchorage, Alaska and Seattle, Washington. A consortium of companies has been selected to design, engineer, manufacture and install the undersea fiber optic cable system and a contract has been signed at a total cost to us of \$35.2 million. We expect to fund construction of the fiber optic cable system through our operating cash flows and, to the extent necessary, with draws on our Senior Facility.

(7) Subsequent Events

On July 21, 2002 MCI and substantially all of its active U.S. subsidiaries filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the United States Bankruptcy Court. Chapter 11 allows a company to continue operating in the ordinary course of business in order to maximize recovery for the company’s creditors and shareholders. During the six months ended June 30, 2002 we recognized \$9.7 million in bad debt expense for uncollected amounts due from MCI. During the three months ended September 30, 2002 we recognized an additional \$1.2 million in bad debt expense. At June 30, 2003 we had total pre-petition amounts due from MCI of \$12.9 million. At June 30, 2003 the bad debt reserve for uncollected amounts due from MCI (“MCI reserve”) totaled \$11.6 million and consisted of all billings for services rendered prior to July 21, 2002 that were not paid or deemed recoverable as of June 30, 2003. The MCI reserve includes approximately \$0.7 million in reserves recognized prior to the bankruptcy in addition to the bad debt expense previously discussed.

On July 22, 2003, the United States Bankruptcy Court approved the settlement of pre-petition amounts owed to us by MCI and affirmed all of our existing contracts with MCI. The settlement settles unpaid balances due from MCI for services rendered prior to their bankruptcy filing date, settles billing

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disputes between us, and establishes a right to set-off certain of our pre-petition accounts payable to MCI. Under the terms of the settlement:

- We will reduce our pre-petition accounts receivable from MCI by approximately \$800,000, and
- We may set-off approximately \$1.0 million of our pre-petition accounts payable to MCI. The \$1.0 million in amounts due from MCI which will be off-set by an equal amount of pre-petition accounts payable was not included in the MCI reserve.

The remaining pre-petition accounts receivable balance owed by MCI to us after these adjustments is \$11.1 million which we will use as a credit against amounts payable for future services purchased from MCI. We expect to reduce the MCI reserve as we utilize credits for services otherwise payable to MCI in the future. We expect to evaluate the likelihood that we will receive full credit offset for our remaining pre-petition accounts receivable balance when MCI exits bankruptcy proceedings and may change our recognition method at that time.

On July 24, 2003, our contract to provide interstate and intrastate long-distance services to MCI was extended for a minimum of five years to July 2008. The agreement sets the terms and conditions under which we originate and terminate certain types of long distance and data services in Alaska on MCI's behalf. In exchange for extending the term of this exclusive contract, MCI will receive a series of rate reductions implemented in phases over the life of the contract.

**PART I.**  
**ITEM 2.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS  
(Unaudited)**

In the following discussion, General Communication, Inc. and its direct and indirect subsidiaries are referred to as "we," "us" and "our."

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the 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. On an on-going basis, we evaluate our estimates and judgments, including those related to unbilled revenues, cost of sales and services accruals, allowance for doubtful accounts, depreciation, amortization and accretion periods, intangible assets, income taxes, and contingencies and litigation. We base our estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. See also our *Cautionary Statement Regarding Forward-Looking Statements*.

**General Overview**

We have experienced significant growth in recent years through strategic acquisitions, deploying new business lines and expansion of our existing businesses. We have historically met our cash needs for operations, regular capital expenditures and maintenance capital expenditures through our cash flows from operating activities. Historically, cash requirements for significant acquisitions and major capital expenditures have been provided largely through our financing activities. We expect to fund the construction of a new fiber optic cable system through our operating cash flows and, to the extent necessary, with draws on our Senior Facility, as further discussed in *Liquidity and Capital Resources* included in Part I, Item 2 of this report.

Consolidated revenues increased by more than \$3 million during the second quarter of 2003 ("2003") as compared to the second quarter in 2002 ("2002"). Our operating income increased by more than \$13 million in 2003. Our net income before income tax and cumulative effect of a change in accounting principle increased by more than \$10 million and our net income increased by almost \$6 million. Three of our reportable business segments experienced growth in external revenues from 2002 to 2003 as we continued to strengthen our position in the markets we serve. The long-distance services segment experienced a decrease in revenue in 2003 as compared to 2002. The long-distance services, cable services and Internet services segments improved their operating results in 2003. The operating results for the local access services segment decreased in 2003. Basic and diluted earnings per share increased \$0.11 per share in 2003 as compared to 2002.

**Long-Distance Services Overview**

Second quarter 2003 long-distance services revenue represented 53.8% of consolidated revenues. Our provision of interstate and intrastate long-distance services, private line and leased dedicated capacity services, and broadband services accounted for 94.6% of our total long-distance services revenues during the second quarter of 2003.

Factors that have the greatest impact on year-to-year changes in long-distance services revenues may include the rate per minute charged to customers, usage volumes expressed as minutes of use, and the number of private line, leased dedicated service and broadband products in use.

Our long-distance services segment faces significant competition from AT&T Alascom, Inc., long-distance resellers, and local telephone companies that have entered the long-distance market. We believe our approach to developing, pricing, and providing long-distance services and bundling different business segment services will continue to allow us to be competitive in providing those services.

Our contract to provide interstate and intrastate long-distance services to Sprint was replaced in March 2002 extending its term to March 2007 with two one-year automatic extensions to March 2009. Beginning in April 2002 the new contract reduced the rate to be charged by us for certain Sprint traffic over the extended term of the contract. Additional contractual rate reductions occur annually through the end of the initial term of the contract.

On July 21, 2002 MCI and substantially all of its active U.S. subsidiaries filed voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the United States Bankruptcy Court. Chapter 11 allows a company to continue operating in the ordinary course of business in order to maximize recovery for the company's creditors and shareholders. During the six months ended June 30, 2002 we recognized \$9.7 million in bad debt expense for uncollected amounts due from MCI. During the three months ended September 30, 2002 we recognized an additional \$1.2 million in bad debt expense. At June 30, 2003 we had total pre-petition amounts due from MCI of \$12.9 million. At June 30, 2003 the bad debt reserve for uncollected amounts due from MCI ("MCI reserve") totaled \$11.6 million and consisted of all billings for services rendered prior to July 21, 2002 that were not paid or deemed recoverable as of June 30, 2003. The MCI reserve includes approximately \$0.7 million in reserves recognized prior to the bankruptcy in addition to the bad debt expense previously discussed.

On July 22, 2003, the United States Bankruptcy Court approved the settlement of pre-petition amounts owed to us by MCI and affirmed all of our existing contracts with MCI. The settlement settles unpaid balances due from MCI for services rendered prior to their bankruptcy filing date, settles billing disputes between us, and establishes a right to set-off certain of our pre-petition accounts payable to MCI. Under the terms of the settlement:

- We will reduce our pre-petition accounts receivable from MCI by approximately \$800,000, and
- We may set-off approximately \$1.0 million of our pre-petition accounts payable to MCI. The \$1.0 million in amounts due from MCI which will be off-set by an equal amount of pre-petition accounts payable was not included in the MCI reserve.

The remaining pre-petition accounts receivable balance owed by MCI to us after these adjustments is \$11.1 million which we will use as a credit against amounts payable for future services purchased from MCI. We expect to reduce the MCI reserve as we utilize credits for services otherwise payable to MCI in the future. We expect to evaluate the likelihood that we will receive full credit offset for our remaining pre-petition accounts receivable balance when MCI exits bankruptcy proceedings and may change our recognition method at that time.

On July 24, 2003, our contract to provide interstate and intrastate long-distance services to MCI was extended for a minimum of five years to July 2008. The agreement sets the terms and conditions under which we originate and terminate certain types of long distance and data services in Alaska on MCI's behalf. In exchange for extending the term of this exclusive contract, MCI will receive a series of rate reductions implemented in phases over the life of the contract.

We believe that MCI may ultimately exit bankruptcy with their business intact. We cannot predict how long it may take MCI to complete the bankruptcy process or what effect the process or the economy may have on their traffic levels and ultimately, their requirements for service to and from Alaska.

Recent announcements, hearings and media coverage reflect a political movement that may be attempting to deny MCI from continuing to provide services to government agencies. We estimate that 25% of our MCI revenues are attributed to their provision of service to government agencies. Our MCI revenues could be significantly reduced if MCI's government contract traffic moves from their network to other carriers' networks for which we do not provide service to.

Other common carrier traffic routed to us for termination in Alaska is largely dependent on traffic routed to MCI and Sprint by their customers. Pricing pressures, general economic deterioration, new program offerings, business failures, and market consolidation continue to evolve in the markets served by MCI and Sprint. If, as a result, their traffic is reduced, or if their competitors' costs to terminate or originate traffic in Alaska are reduced, our traffic will also likely be reduced, and our pricing may be reduced to respond to competitive pressures. We are unable to predict the effect on us of such changes, however given the materiality of other common carrier revenues to us, a significant reduction in traffic or pricing could have a material adverse effect on our financial position, results of operations and liquidity.

Due in large part to the favorable synergistic effects of our integrated approach, the long-distance services segment continues to be a significant contributor to our overall performance, although the migration of traffic from voice to data continues.

### **Cable Services Overview**

Second quarter 2003 cable television revenues represented 24.9% of consolidated revenues. Our cable systems serve 33 communities and areas in Alaska, including the state's four largest population centers, Anchorage, Fairbanks, the Matanuska-Susitna Valley and Juneau.

We generate cable services revenues from four primary sources: (1) digital and analog programming services, including monthly basic and premium subscriptions, pay-per-view movies and other one-time events, such as sporting events; (2) equipment rentals and installation; (3) cable modem services (shared with our Internet services segment); and (4) advertising sales. During the second quarter of 2003 programming services generated 77.6% of total cable services revenues, cable services' allocable share of cable modem services accounted for 11.4% of such revenues, equipment rental and installation fees accounted for 7.0% of such revenues, advertising sales accounted for 3.2% of such revenues, and other services accounted for the remaining 0.8% of total cable services revenues.

Effective February 2003, we increased rates charged for certain cable services and premium packages in six communities, including three of the state's four largest population centers, Anchorage, Fairbanks and Juneau. Rates increased approximately 4% for those customers who experienced an adjustment.

The primary factors that contribute to year-to-year changes in cable services revenues may include average monthly subscription and pay-per-view rates, the mix among basic, premium and pay-per-view services and digital and analog services, the average number of cable television and cable modem subscribers during a given reporting period, and revenues generated from new product offerings.

Our cable services segment faces competition from alternative methods of receiving and distributing television signals, including but not limited to direct broadcast satellite and, expected to begin in the third quarter of 2003, digital video service over telephone lines, and from other sources of news, information and entertainment. Several ILECs in the lower-48 states have announced marketing arrangements to provide direct broadcast satellite services along with local telephone and other services. Similar arrangements could be extended to ILECs in the markets we serve in Alaska. We believe our cable television services will

continue to be competitive by providing, at reasonable prices, a greater variety of communication services than are available off-air or through other alternative delivery sources. Additionally, we believe we offer superior technical performance and responsive community-based customer service.

#### **Local Access Services Overview**

We generate local access services revenues from three primary sources: (1) business and residential basic dial tone services; (2) business private line and special access services; and (3) business and residential features and other charges, including voice mail, caller ID, distinctive ring, inside wiring and subscriber line charges. During the second quarter of 2003 local access services revenues represented 9.6% of consolidated revenues.

The primary factors that contribute to year-to-year changes in local access services revenues may include the average number of business and residential subscribers to our services during a given reporting period, the average monthly rates charged for non-traffic sensitive services, the number and type of additional premium features selected, and the traffic sensitive access rates charged to carriers.

Our local access services segment faces significant competition in Anchorage, Fairbanks, and Juneau from the ILEC ACS and from AT&T Alascom, Inc. We began providing service in the Juneau market in the first quarter of 2002. We believe our approach to developing, pricing, and providing local access services and bundling different business segment services will allow us to be competitive in providing those services.

#### **Internet Services Overview**

We generate Internet services revenues from three primary sources: (1) access product services, including commercial, Internet service provider, and retail dial-up access; (2) network management services; and (3) Internet services' allocable share of cable modem services (a portion of cable modem revenue is also recognized by our cable services segment). During the second quarter of 2003 Internet services segment revenues represented 5.0% of consolidated revenues.

The primary factors that contribute to year-to-year changes in Internet services revenues may include the average number of subscribers to our services during a given reporting period, the average monthly subscription rates, the amount of bandwidth purchased by large commercial customers, and the number and type of additional premium features selected.

Marketing campaigns continue to be deployed targeting residential and commercial customers featuring bundled Internet products. Our Internet offerings are coupled with our long-distance and local access services offerings and provide free basic Internet services or discounted premium Internet services if certain long-distance or local access services plans are selected. Value-added premium Internet features are available for additional charges.

We compete with a number of Internet service providers in our markets. We believe our approach to developing, pricing, and providing Internet services allows us to be competitive in providing those services.

#### **All Other Services Overview**

Revenues reported in the All Other category as described in note 5 in the accompanying *Notes to Interim Condensed Consolidated Financial Statements* include our managed services, product sales, and cellular telephone services.

Revenues included in the All Other category represented 6.7% of total revenues in the second quarter of 2003 and include managed services revenues totaling \$5.3 million, cellular telephone services revenues totaling \$905,000 and product sales revenues totaling \$215,000.

## RESULTS OF OPERATIONS

The following table sets forth selected Statement of Operations data as a percentage of total revenues for the periods indicated (unaudited, underlying data rounded to the nearest thousands):

	Three Months Ended <u>June 30,</u>			Six Months Ended <u>June 30,</u>		
	<u>2003</u>	<u>2002</u>	<u>Percent- age Change<sup>1</sup> 2003 vs. 2002</u>	<u>2003</u>	<u>2002</u>	<u>Percent- age Change<sup>1</sup> 2003 vs. 2002</u>
<i>Statement of Operations Data:</i>						
Revenues						
Long-distance services	53.8%	56.5%	(1.5%)	53.0%	56.6%	(2.3%)
Cable services	24.9%	23.6%	8.9%	25.1%	23.9%	9.3%
Local access services	9.6%	8.8%	14.1%	9.4%	8.5%	14.6%
Internet services	5.0%	4.2%	22.4%	5.0%	4.2%	25.3%
All Other services	6.7%	6.9%	0.5%	7.5%	6.8%	15.8%
Total revenues	100.0%	100.0%	3.4%	100.0%	100.0%	4.3%
Cost of sales and services	31.3%	33.3%	(2.6%)	32.0%	34.3%	(2.9%)
Selling, general and administrative expenses	35.8%	35.1%	5.2%	35.7%	35.3%	5.3%
Bad debt expense	0.8%	11.5%	(92.4%)	0.7%	6.2%	(87.5%)
Depreciation, amortization and accretion expense	13.3%	15.0%	(8.0%)	13.9%	15.4%	(5.6%)
Operating income	18.8%	5.1%	277.1%	17.7%	8.8%	110.1%
Net income (loss) before income taxes and cumulative effect of a change in accounting principle	8.7%	(1.8%)	596.7%	7.3%	1.2%	533.1%
Net income (loss) before cumulative effect of a change in accounting principle	5.0%	(1.2%)	536.1%	4.2%	0.6%	612.8%
Net income (loss)	5.0%	(1.2%)	536.1%	3.9%	0.6%	563.8%
<i>Other Operating Data:</i>						
Long-distance services operating income <sup>2</sup>	45.2%	23.5%	89.8%	43.5%	30.2%	40.5%
Cable services operating income <sup>3</sup>	30.5%	29.1%	14.4%	29.1%	27.9%	13.7%
Local access services operating (loss) income <sup>4</sup>	(5.4%)	5.2%	(218.2%)	(0.7%)	3.0%	(128.1%)
Internet services operating income (loss) <sup>5</sup>	1.4%	(92.2%)	101.9%	(3.8%)	(99.3%)	95.1%

<sup>1</sup> Percentage change in underlying data.

<sup>2</sup> Computed as a percentage of total external long-distance services revenues.

<sup>3</sup> Computed as a percentage of total external cable services revenues.

<sup>4</sup> Computed as a percentage of total external local access services revenues.

<sup>5</sup> Computed as a percentage of total external Internet services revenues.

Three Months Ended June 30, 2003 ("2003") Compared To Three Months Ended June 30, 2002 ("2002").

*Overview of Revenues and Cost of Sales and Services*

Total revenues increased 3.4% from \$92.7 million in 2002 to \$95.9 million in 2003. The cable services, local access services and Internet services segments and All Other Services contributed to the increase in total revenues, partially off-set by a decrease in revenues in the long-distance services segment. See the discussion below for more information by segment.

Total cost of sales and services decreased 2.6% to \$30.1 million in 2003. As a percentage of total revenues, total cost of sales and services decreased from 33.3% in 2002 to 31.3% in 2003. The long-distance services segment contributed to the decrease in total cost of sales and services, partially off-set by increases in cost of sales and services in the cable services, local access services and Internet services segments and All Other Services. See the discussion below for more information by segment.

*Long-distance Services Segment Revenues*

Total long-distance services segment revenues decreased 1.5% to \$51.6 million in 2003.

Message Telephone Service Revenue from Common Carrier Customers

Message telephone service revenues from other common carriers (principally MCI and Sprint) decreased 9.8% to \$23.0 million in 2003 resulting from a 4.2% decrease in wholesale minutes carried to 208.5 million minutes, a 1.8% decrease in the average rate per minute on minutes carried for other common carriers, and a re-rating of certain other common carrier minutes in 2002 that did not recur in 2003.

The economic stagnation in the lower 48 states appears to have dampened demand for services provided by our large common carrier customers. To the extent that these customers experience reduced demand for traffic destined for and originating in Alaska, it could adversely affect our common carrier traffic. A protracted economic malaise in the lower 48 states or a further disruption in the economy resulting from renewed terrorist activity could affect our carrier customers which, in turn, could affect our revenues and cash flows.

Message Telephone Service Revenue from Residential, Commercial and Governmental Customers

Message telephone service revenues from residential, commercial, and governmental customers decreased 14.5% to \$10.2 million in 2003 primarily due to the following:

- A 8.2% decrease in minutes carried for these customers to 72.4 million minutes. The decrease is primarily due to the loss of approximately 1.0 million to 1.5 million minutes earned from a certain retail customer in 2002 but not earned in 2003 and the effect of customers substituting cellular phone and prepaid calling card usage for direct dial minutes,
- A 9.0% decrease in the average rate per minute to \$0.091 per minute paid by these customers due to our promotion of and customers' enrollment in calling plans offering a certain number of minutes for a flat monthly fee, and
- A 2.0% decrease in the number of active residential, commercial, and governmental customers billed to 88,300 at June 30, 2003.

Revenue from Private Line and Private Network Customers

Private line and private network transmission services revenues increased 2.6% to \$9.4 million in 2003.

### Revenue from Broadband Customers

Revenues from our packaged telecommunications offering to rural hospital and health clinic service and our SchoolAccess™ offering to rural school districts increased 37.6% to \$6.3 million in 2003. The increase is primarily due to the following:

- Our new SchoolAccess™ offering called Distance Learning that started in late 2002. Distance Learning is a video-conference based service and is used by six school districts in Alaska,
- An increased number of circuits sold to rural hospitals and health clinics, and
- Equipment sales to one customer.

### *Long-distance Services Segment Cost of Sales and Services*

Long-distance services segment cost of sales and services decreased 13.8% to \$13.0 million in 2003. Long-distance services segment cost of sales and services as a percentage of long-distance services segment revenues decreased from 28.9% in 2002 to 25.3% in 2003 primarily due to the following:

- Reductions in access costs due to distribution and termination of our traffic on our own local access services network instead of paying other carriers to distribute and terminate our traffic. The statewide average cost savings is approximately \$.014 and \$.051 per minute for interstate and intrastate traffic, respectively. We expect cost savings to continue to occur as long-distance traffic originated, carried, and terminated on our own facilities grows,
- The FCC Multi-Association Group (“MAG”) reform order reducing the interstate access rates paid by interexchange carriers to Local Exchange Carriers (“LECs”) beginning July 2002,
- A \$861,000 refund in 2003 from an intrastate access cost pool that previously overcharged us for access services, and
- In the course of business we estimate unbilled long-distance services cost of sales and services based upon minutes of use processed through our network and established rates. Such estimates are revised when subsequent billings are received, payments are made, billing matters are researched and resolved, tariffed billing periods lapse, or when disputed charges are resolved. In 2003 and 2002, we had favorable adjustments of \$749,000 and \$1.8 million, respectively. Excluding the adjustments, long-distance services cost of sales and services as a percentage of long-distance services revenues was 26.7% and 32.3% in 2003 and 2002, respectively.

The decrease in the long-distance services segment cost of sales and services as a percentage of long-distance services segment revenues is partially off-set by increased costs associated with additional transponder and network back-up capacity in 2003 as compared to 2002.

### *Cable Services Segment Revenues and Cost of Sales and Services*

Total cable services segment revenues increased 8.9% to \$23.9 million and average gross revenue per average basic subscriber per month increased \$3.11 or 5.6% in 2003. Programming services revenues increased 9.7% to \$18.5 million in 2003 resulting from the following:

- Basic subscribers served increased approximately 2,100 to approximately 137,200 at June 30, 2003 as compared to June 30, 2002,
- New facility construction efforts in 2002 and 2003 resulted in approximately 5,600 additional homes passed, a 2.9% increase from June 30, 2002. New facility construction efforts in 2003 resulted in approximately 4,600 additional homes passed and a review of homes passed in the system acquired from Rogers American Cablesystems, Inc. resulted in approximately 1,000 additional homes passed,
- Digital subscriber counts increased 16.3% to approximately 30,700 at June 30, 2003 as compared to June 30, 2002, and
- Effective February 2003, we increased rates charged for certain cable services and premium packages in six communities, including three of the state's four largest population centers Anchorage,

Fairbanks and Juneau. Rates increased approximately 4% for those customers who experienced an adjustment.

The cable services segment's share of cable modem revenue (offered through our Internet services segment) increased \$750,000 to \$2.7 million in 2003 due to an increased number of cable modems deployed. Approximately 99% of our cable homes passed are able to subscribe to our cable modem service. In the second quarter of 2003 we completed our upgrade of the Ketchikan cable system. Customers in this system are now able to subscribe to cable modem service.

We now offer digital programming service in Anchorage, the Matanuska-Susitna Valley, Fairbanks, Juneau, Kenai, and Soldotna, representing approximately 85% of our total homes passed at June 30, 2003. We expect that number will increase to approximately 89% when digital programming service is launched in the Ketchikan cable system during the third quarter of 2003.

In the second quarter of 2002 we signed new seven-year retransmission agreements with the five local Anchorage broadcasters and began up-linking and distributing the local Anchorage programming to all of our cable systems. This was done to provide additional value to our cable subscribers and to allow us to differentiate our programming from that of our DBS competitors.

Cable services cost of sales and services increased 5.8% to \$6.4 million in 2003 due to programming cost increases for most of our cable programming services offerings. Cable services cost of sales and services as a percentage of cable services revenues, which is less as a percentage of revenues than are local access and Internet services cost of sales and services, decreased from 27.5% in 2002 to 26.7% in 2003. The decrease is primarily due to a \$182,000 favorable adjustment to cable services cost of sales and services after completion of audits by certain cable programming service vendors, and increasing amounts of cable modem services sold that generally have higher margins than do cable programming services.

#### *Local Access Services Segment Revenues and Cost of Sales and Services*

Local access services segment revenues increased 14.1% in 2003 to \$9.2 million primarily due to growth in the average number of customers served. At June 30, 2003 an estimated 101,900 lines were in service as compared to approximately 95,800 lines in service at June 30, 2002. We estimate that our 2003 lines in service total represents a statewide market share of approximately 21%. At June 30, 2003 approximately 1,000 additional lines were awaiting connection. The increase in local access services segment revenues is also caused by a change in how we provision local access lines in Fairbanks and Juneau. In 2002 we primarily resold service purchased from ACS. In 2003 we are benefiting from our facilities build-out with an increased number of access lines provisioned on our own facilities, unbundled network element ("UNE") loop and UNE platform which allows us to collect interstate and intrastate access revenues. The increase in local access services revenues described above was partially off-set by the following:

- The FCC MAG reform order reducing the interstate access rates paid by interexchange carriers to LECs beginning July 2002, and
- A reduction in July 2002 in interstate access rates charged by us to interexchange carriers in response to an FCC order forcing a competitor to reduce their interstate access rates.

Local access services segment cost of sales and services increased 19.1% to \$5.9 million in 2003. Local access services segment cost of sales and services as a percentage of local access services segment revenues increased from 60.8% in 2002 to 63.4% in 2003, primarily due to the following:

- Decreased network access services revenues from other carriers as the number of customers purchasing both long-distance and local access services from us increases, and
- The effect of the revenue decreases from interstate access rates described above with no corresponding decrease in the cost of sales and services.

Partially offsetting the items described above are reductions in access costs attributed to our conversion of service provided on a wholesale basis to service provided through our own facilities.

Our access line mix at June 30, 2003 follows:

- Residential lines represent approximately 57% of our lines,
- Business customers represent approximately 35% of our lines, and
- Internet access customers represent approximately 8% of our lines.

Approximately 87% of our lines are provided on our own facilities and leased local loops. Approximately 5% of our lines are provided using UNE platform.

The local access services segment operating results are negatively affected by the allocation of the benefit of access cost savings to the long-distance services segment. If the local access services segment received credit for the access charge reductions recorded by the long distance services segment, the local access services segment operating results would have improved by approximately \$1.7 million and the long distance services segment operating results would have been reduced by an equal amount in the second quarter of 2003. Avoided access charges totaled approximately \$1.7 million during the second quarter of 2003 as compared to \$2.1 in the same period of 2002. The decrease in the avoided access charge in the second quarter of 2003 is due to the FCC MAG reform order reducing the interstate access rates paid by interexchange carriers to LECs beginning July 2002 and a reduction in July 2002 in interstate access rates charged by us to interexchange carriers in response to an FCC order forcing a competitor to reduce their interstate access rates. The local access services segment operating results are affected by our continued evaluation and testing of digital local phone service and Internet protocol-based technology to deliver phone service through our cable facilities.

#### *Internet Services Segment Revenues and Cost of Sales and Services*

Total Internet services segment revenues increased 22.4% to \$4.8 million in 2003 primarily due to a 34.7% increase in its allocable share of cable modem revenues to \$2.2 million in 2003 as compared to 2002. The increase in cable modem revenues is primarily due to growth in the number of cable modems deployed. Cable modem subscribers increased from approximately 31,300 at June 30, 2002 to approximately 40,500 at June 30, 2003.

At June 30, 2003 we had 92,200 total Internet subscribers, which includes 51,700 dial-up subscribers who do not have any form of cable modem service and 24,900 dial-up subscribers who also have cable modem service. At June 30, 2003 approximately 6,300 of the dial-up subscribers who also have cable modem service have not activated their dial-up service. Our total dial-up Internet subscribers decreased 1,100 to 70,300 subscribers at June 30, 2003 as compared to June 30, 2002 as more customers continue to migrate to cable modems.

We reported a total of 71,400 Internet subscribers at June 30, 2002. This subscriber count was based upon the total number of active dial-up subscribers at June 30, 2002. As discussed above, not all cable modem subscribers paying for a dial-up plan have activated their dial-up service. When we first started selling cable modem service it was packaged in a way that almost all cable modem subscribers were also dial up subscribers. As we introduced new packages and plans and started promoting our new cable modem LiteSpeed service the number of cable modem subscribers without a dial up plan increased substantially. An internal review during the second quarter of 2003 revealed that these subscriber counts had risen substantially enough that they should be reported separately. In future quarters we will report Internet subscribers in the format described above.

The Internet services segment does not share in plan fee revenues associated with our bundled Internet and long-distance service package. Estimated plan fees related to this service offering are approximately \$1.0 million per quarter and those revenues are included in the long-distance services segment.

Internet services cost of sales and services increased 23.5% to \$1.4 million in 2003, and as a percentage of Internet services revenues, totaled 29.7% and 29.4% in 2003 and 2002, respectively. The 2003 increase as a percentage of Internet services revenues is primarily due to increased labor costs. The increase is partially off-set by a \$571,000 increase in Internet's portion of cable modem revenue to \$2.2 million that generally has higher margins than do other Internet services products. As Internet services revenues increase, economies of scale and more efficient network utilization continue to result in reduced Internet cost of sales and services as a percentage of revenues.

We enhanced the value of our Internet offerings throughout 2002 through the addition of electronic billing and presentment capabilities and the rollout of a product called eMail Guard, which filters out e-mail spam and viruses. We upgraded the download speeds of all of our cable modem Internet service offerings. These new services and enhancements have proven to be popular with our customers which we believe is helping to further solidify our customer relationships.

#### *All Other Revenues and Costs of Sales and Services*

All Other revenues increased 0.5% to \$6.5 million in 2003.

Revenues from our GCI Fiber system that runs along the oil pipeline corridor are continuing to increase and we expect the annual recurring revenue run rate to increase by an additional two to three million dollars per year by the end of 2003. Additionally, we expect to recognize approximately seven million dollars in special project revenue in the fourth quarter of 2003.

All Other costs of sales and services decreased 7.2% to \$3.4 million in 2003, and as a percentage of All Other revenues, totaled 52.5% and 56.8% in 2003 and 2002, respectively. The decrease in All Other costs of sales and services as a percentage of All Other revenues is primarily due to a \$140,000 favorable adjustment due to a revision of an estimate of a previously unbilled cost of sales and service upon receipt of the invoice.

#### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses increased 5.2% to \$34.3 million in 2003 and, as a percentage of total revenues, increased to 35.8% in 2003 from 35.1% in 2002. The 2003 increase in selling, general and administrative expenses is primarily due to an increased accrual for company-wide success sharing bonus costs and increased labor costs. The 2003 increase is off-set by costs incurred in 2002 for our unsuccessful bid to purchase certain assets of WCI Cable, Inc. and its subsidiaries.

Marketing and advertising expenses as a percentage of total revenues decreased from 2.6% in 2002 to 2.3% in 2003.

#### *Bad Debt Expense*

Bad debt expense decreased 92.4% to \$802,000 in 2003 and, as a percentage of total revenues, decreased to 0.8% in 2003 from 11.5% in 2002. The 2003 decrease is primarily due to the provision of a \$9.7 million bad debt reserve for uncollected amounts due from MCI resulting from substantially all of its active U.S. subsidiaries filing voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York on July 21, 2002. For a discussion of the settlement of the uncollected amounts due from MCI, see *Long Distance Service Overview* included in Part I, Item 2 of this report.

#### *Depreciation, Amortization and Accretion Expense*

Depreciation, amortization and accretion expense decreased 8.0% to \$12.8 million in 2003. The decrease is primarily attributed to a reduction in the value of Property and Equipment due to an adjustment of \$18.5 million which was recorded in 2002 associated with the Kanas Telecom, Inc acquisition.

The decrease in depreciation, amortization and accretion expense described above was partially off-set by an increase in depreciation expense due to our \$59.2 million investment in equipment and facilities placed into service during 2002 for which a full year of depreciation will be recorded in 2003, and the \$20.8 million investment in equipment and facilities placed into service during 2003 for which a partial year of depreciation will be recorded in 2003.

#### *Other Expense, Net*

Other expense, net of other income, increased 48.8% to \$9.6 million in 2003. The increase is primarily due to the following:

- Increased interest expense due to the increased interest rate paid on our amended Senior Facility,
- Increased deferred loan fee expense due to increased deferred loan fees associated with the amended Senior Facility, and
- A \$961,000 interest benefit earned in 2002 from an interest rate swap agreement which was called at no cost and terminated on August 1, 2002.

Partially offsetting these increases was a decrease in the average outstanding indebtedness in 2003.

#### *Income Tax (Expense) Benefit*

Income tax (expense) benefit was (\$3.6) million in 2003 and \$583,000 in 2002. The change was due to increased net income before income taxes and cumulative effect of a change in accounting principle in 2003 as compared to 2002. Our effective income tax rate changed from 34.6% in 2002 to 42.6% in 2003 due to the effect of items that are nondeductible for income tax purposes.

At June 30, 2003, we have (1) tax net operating loss carryforwards of approximately \$196.6 million that will begin expiring in 2005 if not utilized, and (2) alternative minimum tax credit carryforwards of approximately \$1.9 million available to offset regular income taxes payable in future years. Our utilization of certain net operating loss carryforwards is subject to limitations pursuant to Internal Revenue Code section 382.

Tax benefits associated with recorded deferred tax assets are considered to be more likely than not realizable through future reversals of existing taxable temporary differences and future taxable income exclusive of reversing temporary differences and carryforwards. The amount of deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced which would result in additional income tax expense. We estimate that our effective income tax rate for financial statement purposes will be 42% to 45% in 2003.

#### *Six Months Ended June 30, 2003 ("2003") Compared To Six Months Ended June 30, 2002 ("2002").*

##### *Overview of Revenues and Cost of Sales and Services*

Total revenues increased 4.3% from \$181.0 million in 2002 to \$188.7 million in 2003. The cable services, local access services and Internet services segments and All Other Services contributed to the increase in total revenues, partially off-set by a decrease in revenues in the long-distance services segment. See the discussion below for more information by segment.

Total cost of sales and services decreased 2.9% to \$60.3 million in 2003. As a percentage of total revenues, total cost of sales and services decreased from 34.3% in 2002 to 32.0% in 2003. The long-distance services segment contributed to the decrease in total cost of sales and services, partially off-set by increases in costs of sales and services in the cable services, local access services and Internet services segments and All Other Services. See the discussion below for more information by segment.

#### *Long-distance Services Segment Revenues*

Total long-distance services segment revenues decreased 2.3% to \$100.1 million in 2003.

#### Message Telephone Service Revenue from Common Carrier Customers

Message telephone service revenues from other common carriers (principally MCI and Sprint) decreased 8.6% to \$44.0 million in 2003 resulting from a 2.4% decrease in wholesale minutes carried to 395.7 million minutes and a 6.3% decrease in the average rate per minute on minutes carried for other common carriers. The average rate per minute decrease is primarily due to a reduced rate charged by us for certain Sprint traffic due to a new contract commencing April 2002.

The economic stagnation in the lower 48 states appears to have dampened demand for services provided by our large common carrier customers. To the extent that these customers experience reduced demand for traffic destined for and originating in Alaska, it could adversely affect our common carrier traffic. A protracted economic malaise in the lower 48 states or a further disruption in the economy resulting from renewed terrorist activity could affect our carrier customers which, in turn, could affect our revenues and cash flows.

#### Message Telephone Service Revenue from Residential, Commercial and Governmental Customers

Message telephone service revenues from residential, commercial, and governmental customers decreased 15.0% to \$20.4 million in 2003 primarily due to the following:

- A 9.6% decrease in minutes carried for these customers to 144.4 million minutes. The decrease is primarily due to the loss of approximately 4.0 million to 4.5 million minutes earned from a certain retail customer in 2002 but not earned in 2003 and the effect of customers substituting cellular phone and prepaid calling card usage for direct dial minutes,
- A 7.9% decrease in the average rate per minute to \$0.093 per minute paid by these customers due to our promotion of and customers' enrollment in calling plans offering a certain number of minutes for a flat monthly fee, and
- A 2.0% decrease in the number of active residential, commercial, and governmental customers billed to 88,300 at June 30, 2003.

#### Revenue from Private Line and Private Network Customers

Private line and private network transmission services revenues increased 1.3% to \$18.2 million in 2003.

#### Revenue from Broadband Customers

Revenues from our packaged telecommunications offering to rural hospital and health clinic service and our SchoolAccess™ offering to rural school districts increased 33.6% to \$12.0 million in 2003. The increase is primarily due to the following:

- Our new SchoolAccess™ offering called Distance Learning that started in late 2002. Distance Learning is a video-conference based service and is used by six school districts in Alaska,
- An increased number of circuits sold to rural hospitals and health clinics, and
- Equipment sales to one customer.

#### *Long-distance Services Segment Cost of Sales and Services*

Long-distance services segment cost of sales and services decreased 19.9% to \$25.1 million in 2003. Long-distance services segment cost of sales and services as a percentage of long-distance services segment revenues decreased from 30.6% in 2002 to 25.1% in 2003 primarily due to the following:

- Reductions in access costs due to distribution and termination of our traffic on our own local access services network instead of paying other carriers to distribute and terminate our traffic. The statewide average cost savings is approximately \$.014 and \$.051 per minute for interstate and intrastate traffic, respectively. We expect cost savings to continue to occur as long-distance traffic originated, carried, and terminated on our own facilities grows,
- The FCC MAG reform order reducing the interstate access rates paid by interexchange carriers to LECs beginning July 2002,
- A \$2.3 million refund (\$1.9 million after deducting certain direct costs) in 2003 from a local exchange carrier in respect of its earnings that exceeded regulatory requirements,
- A \$861,000 refund in 2003 from an intrastate access cost pool that previously overcharged us for access services, and
- In the course of business we estimate unbilled long-distance services cost of sales and services based upon minutes of use processed through our network and established rates. Such estimates are revised when subsequent billings are received, payments are made, billing matters are researched and resolved, tariffed billing periods lapse, or when disputed charges are resolved. In 2003 and 2002, we had favorable adjustments of \$749,000 and \$2.5 million, respectively. Excluding the adjustments, long-distance services cost of sales and services as a percentage of long-distance services revenues was 25.8% and 33.0% in 2003 and 2002, respectively.

The decrease in the long-distance services segment cost of sales and services as a percentage of long-distance services segment revenues is partially off-set by increased costs associated with additional transponder and network back-up capacity in 2003 as compared to 2002.

#### *Cable Services Segment Revenues and Cost of Sales and Services*

Total cable services segment revenues increased 9.3% to \$47.3 million and average gross revenue per average basic subscriber per month increased \$4.27 or 7.8% in 2003. Programming services revenues increased 9.7% to \$36.8 million in 2003 resulting from the following:

- Basic subscribers served increased approximately 2,100 to approximately 137,200 at June 30, 2003 as compared to June 30, 2002,
- New facility construction efforts in 2002 and 2003 resulted in approximately 5,600 additional homes passed, a 2.9% increase from June 30, 2002. New facility construction efforts in 2003 resulted in approximately 4,600 additional homes passed and a review of homes passed in the system acquired from Rogers American Cablesystems, Inc. resulted in approximately 1,000 additional homes passed,
- Digital subscriber counts increased 16.3% to approximately 30,700 at June 30, 2003 as compared to June 30, 2002, and
- Effective February 2003, we increased rates charged for certain cable services and premium packages in six communities, including three of the state's four largest population centers Anchorage, Fairbanks and Juneau. Rates increased approximately 4% for those customers who experienced an adjustment.

The cable services segment's share of cable modem revenue (offered through our Internet services segment) increased 44.0% to \$5.2 million in 2003 due to an increased number of cable modems deployed.

Approximately 99% of our cable homes passed are able to subscribe to our cable modem service. In the second quarter of 2003 we completed our upgrade of the Ketchikan cable system. Customers in this system are now able to subscribe to cable modem service.

We now offer digital programming service in Anchorage, the Matanuska-Susitna Valley, Fairbanks, Juneau, Kenai, and Soldotna, representing approximately 85% of our total homes passed at June 30, 2003. We expect that number will increase to approximately 89% when digital programming service is launched in the Ketchikan cable system during the third quarter of 2003.

In the second quarter of 2002 we signed new seven-year retransmission agreements with the five local Anchorage broadcasters and began up-linking and distributing the local Anchorage programming to all of our cable systems. This was done to provide additional value to our cable subscribers and to allow us to differentiate our programming from that of our DBS competitors.

Cable services cost of sales and services increased 7.1% to \$12.8 million in 2003 due to programming cost increases for most of our cable programming services offerings. Cable services cost of sales and services as a percentage of cable services revenues, which is less as a percentage of revenues than are local access and Internet services cost of sales and services, decreased from 27.7% in 2002 to 27.1% in 2003. The decrease is primarily due to the following:

- A \$182,000 favorable adjustment to cable services cost of sales and services after completion of audits by certain cable programming service vendors,
- Increased revenue resulting from increased rates charged for certain cable services and premium packages as described above, and
- Increasing amounts of cable modem services sold that generally have higher margins than do cable programming services.

In October 2002 we, along with the other largest publicly traded multiple system operators (“MSOs”) signed a pledge to support and adhere to new voluntary reporting guidelines on common operating statistics to provide investors and others with a better understanding of our operations. Our operating statistics include capital expenditures and customer information from our cable services, local access services and Internet services segments.

Our capital expenditures by standard reporting category for the six months ending June 30, 2003 and 2002 follows (amounts in thousands):

	<u>2003</u>	<u>2002</u>
Customer premise equipment (“CPE”) \$	3,830	3,233
Commercial	171	325
Scalable infrastructure	459	2,199
Line extensions	243	242
Upgrade/rebuild	963	2,533
Support capital	263	4,118
	<u>\$ 5,929</u>	<u>12,650</u>

During the six months ending June 30, 2003 we decreased our capital expenditures for all of our reportable segments as compared to the same period in 2002. The decrease was due, in part, to capital expenditure limitations required by our Senior Facility, which we closed on November 1, 2002. In April 2003 we amended our Senior Facility agreement which, among other items, increases the amount we may incur for capital expenditures. For a discussion of the Senior Facility amendment, see *Liquidity and Capital Resources* included in Part I, Item 2 of this report.

The standardized definition of a customer relationship is the number of customers that receive at least one level of service, encompassing voice, video, and data services, without regard to which services customers purchase. At June 30, 2003 and 2002 we have 124,318 and 123,257 customer relationships, respectively.

The standardized definition of a revenue generating unit is the sum of all primary analog video, digital video, high-speed data, and telephony customers, not counting additional outlets. At June 30, 2003 and 2002 we have 177,793 and 166,432 revenue generating units, respectively. The increase in the revenue generating units of 4,512 and 3,852 from March 31, 2003 and 2002, respectively, is due to an increase in the number of hotels which subscribe to cable television services for their summer tourist season. Each hotel room is considered to be a revenue generating unit.

#### *Local Access Services Segment Revenues and Cost of Sales and Services*

Local access services segment revenues increased 14.6% in 2003 to \$17.7 million primarily due to growth in the average number of customers served. At June 30, 2003 an estimated 101,900 lines were in service as compared to approximately 95,800 lines in service at June 30, 2002. We estimate that our 2003 lines in service total represents a statewide market share of approximately 21%. At June 30, 2003 approximately 1,000 additional lines were awaiting connection. The increase in local access services segment revenues is also caused by a change in how we provision local access lines in Fairbanks and Juneau. In 2002 we primarily resold service purchased from ACS. In 2003 we are benefiting from our facilities build-out with an increased number of access lines provisioned on our own facilities, unbundled network element (“UNE”) loop and UNE platform which allows us to collect interstate and intrastate access revenues. The increase in local access services revenues described above was partially off-set by the following:

- The FCC MAG reform order reducing the interstate access rates paid by interexchange carriers to LECs beginning July 2002, and
- A reduction in July 2002 in interstate access rates charged by us to interexchange carriers in response to an FCC order forcing a competitor to reduce their interstate access rates.

Local access services segment cost of sales and services increased 19.5% to \$11.5 million in 2003. Local access services segment cost of sales and services as a percentage of local access services segment revenues increased from 62.5% in 2002 to 65.2% in 2003, primarily due to the following:

- Decreased network access services revenues from other carriers as the number of customers purchasing both long-distance and local access services from us increases, and
- The effect of the revenue decreases from interstate access rates described above with no corresponding decrease in the cost of sales and services.

Partially offsetting the items described above are reductions in access costs attributed to our conversion of service provided on a wholesale basis to service provided through our own facilities.

Our access line mix at June 30, 2003 follows:

- Residential lines represent approximately 57% of our lines,
- Business customers represent approximately 35% of our lines, and
- Internet access customers represent approximately 8% of our lines.

Approximately 87% of our lines are provided on our own facilities and leased local loops. Approximately 5% of our lines are provided using UNE platform.

The local access services segment operating results are negatively affected by the allocation of the benefit of access cost savings to the long-distance services segment. If the local access services segment received credit for the access charge reductions recorded by the long distance services segment, the local access services segment operating results would have improved by approximately \$3.5 million and the long distance services segment operating results would have been reduced by an equal amount in 2003. Avoided access charges totaled approximately \$3.5 million during 2003 as compared to \$4.1 in 2002. The decrease in the avoided access charge in 2003 is due to the FCC MAG reform order reducing the interstate access rates paid by

interexchange carriers to LECs beginning July 2002 and a reduction in July 2002 in interstate access rates charged by us to interexchange carriers in response to an FCC order forcing a competitor to reduce their interstate access rates. The local access services segment operating results are affected by our continued evaluation and testing of digital local phone service and Internet protocol-based technology to deliver phone service through our cable facilities.

*Internet Services Segment Revenues and Cost of Sales and Services*

Total Internet services segment revenues increased 25.3% to \$9.4 million in 2003 primarily due to the \$1.3 million increase in its allocable share of cable modem revenues to \$4.3 million in 2003 as compared to 2002. The increase in cable modem revenues is primarily due to growth in the number of cable modems deployed. Approximately 40,500 of the total Internet subscribers are cable modem subscribers at June 30, 2003 as compared to approximately 31,300 at June 30, 2002.

At June 30, 2003 we had 92,200 total Internet subscribers, which includes 51,700 dial-up subscribers who do not have any form of cable modem service and 24,900 dial-up subscribers who also have cable modem service. At June 30, 2003 approximately 6,300 of the dial-up subscribers who also have cable modem service have not activated their dial-up service. Our total dial-up Internet subscribers decreased 1,100 to 70,300 subscribers at June 30, 2003 as compared to June 30, 2002 as more customers continue to migrate to cable modems. .

We reported a total of 71,400 Internet subscribers at June 30, 2002. This subscriber count was based upon the total number of active dial-up subscribers at June 30, 2002. As discussed above, not all cable modem subscribers paying for a dial-up plan have activated their dial-up service. When we first started selling cable modem service it was packaged in a way that almost all cable modem subscribers were also dial up subscribers. As we introduced new packages and plans and started promoting our new cable modem LiteSpeed service the number of cable modem subscribers without a dial up plan increased substantially. An internal review during the second quarter of 2003 revealed that these subscriber counts had risen substantially enough that they should be reported separately. In future quarters we will report Internet subscribers in the format described above.

The Internet services segment does not share in plan fee revenues associated with our bundled Internet and long-distance service package. Estimated plan fees related to this service offering are approximately \$1.0 million per quarter and those revenues are included in the long-distance services segment.

Internet services cost of sales and services increased 20.5% to \$2.8 million in 2003, and as a percentage of Internet services revenues, totaled 30.1% and 31.3% in 2003 and 2002, respectively. The 2003 decrease as a percentage of Internet services revenues is primarily due to a \$1.3 million increase in Internet's portion of cable modem revenue that generally has higher margins than do other Internet services products. As Internet services revenues increase, economies of scale and more efficient network utilization continue to result in reduced Internet cost of sales and services as a percentage of revenues.

We enhanced the value of our Internet offerings throughout 2002 through the addition of electronic billing and presentment capabilities and the rollout of a product called eMail Guard, which filters out e-mail spam and viruses. We upgraded the download speeds of all of our cable modem Internet service offerings. These new services and enhancements have proven to be popular with our customers which we believe is helping to further solidify our customer relationships.

#### *All Other Revenues and Costs of Sales and Services*

All Other revenues increased 15.8% to \$14.3 million in 2003. The increase in revenues is primarily due to the following:

- A \$1.3 million increase in product sales to \$1.8 million due to sales of product to two customers in 2003, and
- A \$508,000 increase in managed services revenue to \$10.8 million in 2003 primarily due to a one-time payment of \$327,000 from a customer to acknowledge our ability to maintain certain costs below a stated budget.

Revenues from our GCI Fiber system that runs along the oil pipeline corridor are continuing to increase and we expect the annual recurring revenue run rate to increase by an additional two to three million dollars per year by the end of 2003. Additionally, we expect to recognize approximately seven million dollars in special project revenue in the fourth quarter of 2003.

All Other costs of sales and services increased 18.0% to \$8.1 million in 2003, and as a percentage of All Other revenues, totaled 56.3% and 55.3% in 2003 and 2002, respectively. The increase in All Other costs of sales and services as a percentage of All Other revenues is primarily due to the sales of product to two customers in 2003 which have a higher costs of sales as a percentage of revenues than do managed services. The increase in All Other costs of sales and services as a percentage of All Other revenues is partially off-set by a \$140,000 favorable adjustment due to a revision of an estimate of a previously unbilled cost of sales and service upon receipt of the invoice.

#### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses increased 5.3% to \$67.3 million in 2003 and, as a percentage of total revenues, increased to 35.7% in 2003 from 35.3% in 2002. The 2003 increase in selling, general and administrative expenses is primarily due to an increased accrual for company-wide success sharing bonus costs, increased labor costs and costs associated with State of Alaska regulatory affairs.

Marketing and advertising expenses as a percentage of total revenues decreased from 3.4% in 2002 to 2.5% in 2003.

#### *Bad Debt Expense*

Bad debt expense decreased 87.5% to \$1.4 million in 2003 and, as a percentage of total revenues, decreased to 0.7% in 2003 from 6.2% in 2002. The 2003 decrease is primarily due to the provision of a \$9.7 million bad debt reserve for uncollected amounts due from MCI resulting from substantially all of its active U.S. subsidiaries filing voluntary petitions for reorganization under Chapter 11 of the U.S. Bankruptcy Code in the United States Bankruptcy Court for the Southern District of New York on July 21, 2002. For a discussion of the settlement of the uncollected amounts due from MCI, see *Long Distance Service Overview* included in Part I, Item 2 of this report.

#### *Depreciation, Amortization and Accretion Expense*

Depreciation, amortization and accretion expense decreased 5.6% to \$26.3 million in 2003. The decrease is primarily attributed to a reduction in the value of Property and Equipment due to an adjustment of \$18.5 million which was recorded in 2002 associated with the Kanas Telecom, Inc. acquisition.

The decrease in depreciation, amortization and accretion expense described above was partially off-set by an increase in depreciation expense due to our \$59.2 million investment in equipment and facilities placed into service during 2002 for which a full year of depreciation will be recorded in 2003, and the \$20.8 million investment in equipment and facilities placed into service during 2003 for which a partial year of depreciation will be recorded in 2003.

*Other Expense, Net*

Other expense, net of other income, increased 43.2% to \$19.7 million in 2003. The increase is primarily due to the following:

- Increased interest expense due to the increased interest rate paid on our amended Senior Facility,
- Increased deferred loan fee expense due to the increased deferred loan fees associated with the amended Senior Facility, and
- A \$1.4 million interest benefit earned in 2002 from an interest rate swap agreement which was called at no cost and terminated on August 1, 2002.

Partially offsetting these increases was a decrease in the average outstanding indebtedness in 2003.

*Income Tax Expense*

Income tax expense was \$5.8 million in 2003 and \$1.1 million in 2002. The change was due to increased net income before income taxes and cumulative effect of a change in accounting principle in 2003 as compared to 2002. Our effective income tax rate decreased from 48.9% in 2002 to 42.5% in 2003 due to the effect of items that are nondeductible for income tax purposes.

***FLUCTUATIONS IN QUARTERLY RESULTS OF OPERATIONS***

The following chart provides selected unaudited statement of operations data from our quarterly results of operations during 2003 and 2002:

	<u>(Amounts in thousands, except per share amounts)</u>				
	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>	<u>Total</u>
	<u>Quarter</u>	<u>Quarter</u>	<u>Quarter</u>	<u>Quarter</u>	
<u>2003</u>					
Revenues:					
Long-distance services	\$ 48,486	51,570			100,056
Cable services	\$ 23,438	23,872			47,310
Local access services	\$ 8,426	9,245			17,671
Internet services	\$ 4,590	4,790			9,380
All Other services	\$ 7,837	6,462			14,299
Total revenues	\$ 92,777	95,939			188,716
Operating income	\$ 15,438	17,972			33,410
Net income before income taxes and cumulative effect of a change in accounting principle	\$ 5,377	8,374			13,751
Net income before cumulative effect of a change in accounting principle	\$ 3,095	4,810			7,905
Net income	\$ 2,551	4,810			7,361
Basic and diluted net income per common share:					
Net income before cumulative effect of a change in accounting principle <sup>1</sup>	\$ 0.05	0.8			0.12
Cumulative effect of a change in accounting principle	\$ (0.01)	---			(0.01)
Net income <sup>1</sup>	\$ 0.04	0.8			0.11

	(Amounts in thousands, except per share amounts)				
	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
<u>2002</u>					
Revenues:					
Long-distance services	\$ 50,068	52,375	53,778	48,711	204,932
Cable services	\$ 21,346	21,919	22,057	23,366	88,688
Local access services	\$ 7,308	8,106	8,096	8,561	32,071
Internet services	\$ 3,573	3,912	3,927	4,172	15,584
All Other services	\$ 5,915	6,428	6,692	7,532	26,567
Total revenues	\$ 88,210	92,740	94,550	92,342	367,842
Operating income <sup>2</sup>	\$ 11,133	4,766	16,353	13,473	45,725
Net income (loss) before income taxes <sup>2</sup>	\$ 3,858	(1,686)	8,662	1,488	12,322
Net income (loss) <sup>2</sup>	\$ 2,212	(1,103)	5,063	491	6,663
Basic and diluted net income (loss) per common share <sup>2</sup>	\$ 0.03	(0.03)	0.08	0.00	0.08

<sup>1</sup> Due to rounding, the sum of quarterly net income per common share amounts does not agree to total net income per common share amounts.

<sup>2</sup> The second and third quarters of 2002 include the provision of \$9.7 million and \$1.2 million, respectively, of bad debt expense for estimated uncollectible accounts due from MCI.

#### *Overview of Revenues and Cost of Sales and Services*

Total revenues for the quarter ended June 30, 2003 (“second quarter”) were \$95.9 million, representing a 3.4% increase from \$92.8 million for the quarter ended March 31, 2003 (“first quarter”). The long-distance services, cable services, local services and Internet services segments contributed to the increase in total revenues, partially off-set by a decrease in revenues from All Other Services.

Cost of sales and services decreased from \$30.2 million in the first quarter to \$30.1 million in the second quarter. As a percentage of revenues, first and second quarter cost of sales and services totaled 32.6% and 31.3%, respectively. The cable services segment and All Other Services contributed to the decrease in total cost of sales and services, partially off-set by increases in cost of sales and services in the long-distance, local access and Internet services segments.

#### *Long-distance Services Segment Revenues and Cost of Sales and Services*

Second quarter long-distance services segment revenues increased 6.4% to \$51.6 million as compared to the first quarter. The increase resulted primarily from increased revenues from other common carrier customers and increased private line and broadband revenues, off-set by a decrease in revenues from residential, commercial, and governmental customers.

Revenues from other common carrier customers increased 9.0% to \$23.0 million in the second quarter as compared to the first quarter. Minutes carried for other common carriers increased 11.4% to 208.5 million minutes. The increased revenues from other common carrier customers was partially off-set by a 2.2% decrease in the average rate per minute on minutes carried for other common carriers in the second quarter as compared to the first quarter.

Revenues from residential, commercial, and governmental customers decreased 0.1% to \$10.2 million in the second quarter primarily due to a 3.2% decrease in the average rate per minute to \$0.091 per minute paid by residential, commercial and governmental customers.

The decrease described above is partially off-set by the following:

- A 1.1% increase in the number of active residential, commercial, and governmental customers billed to 88,300 at June 30, 2003, and
- A 0.7% increase in retail minutes carried for residential, commercial and governmental customers to 72.4 million minutes.

Private line and private network transmission services revenues increased 6.1% to \$9.4 million in second quarter as compared to first quarter. The increase is primarily due to an increased number of leased circuits in service and approximately \$175,000 in credits given to customers in the first quarter.

Long-distance revenues have historically been highest in the summer months because of temporary population increases attributable to tourism and increased seasonal economic activity such as construction, commercial fishing, and oil and gas activities.

Revenues from our packaged telecommunications offering to rural hospital and health clinic service and our SchoolAccess™ offering to rural school districts increased 9.1% to \$6.3 million in the second quarter. The increase is primarily due to the following:

- Our new SchoolAccess™ offering called Distance Learning that started in late 2002. Distance Learning is a video-conference based service and is used by six school districts in Alaska,
- An increased number of circuits sold to rural hospitals and health clinics, and
- Equipment sales to one customer.

Long-distance services cost of sales and services increased 7.8% to \$13.0 million in the second quarter. Long-distance services cost of sales and services as a percentage of long-distance services revenues increased from 24.9% in the first quarter to 25.3% in the second quarter primarily due to a \$2.3 million refund in the first quarter from a local exchange carrier in respect of its earnings that exceeded regulatory requirements.

Partially off-setting the increased long-distance services cost of sales and services as a percentage of long-distance services revenues in the second quarter as compared to the first quarter were the following:

- A \$861,000 refund in the second quarter from an intrastate access cost pool that previously overcharged us for access services, and
- A favorable adjustment of \$749,000 in the second quarter. In the course of business we estimate unbilled long-distance services cost of sales and services based upon minutes of use processed through our network and established rates. Such estimates are revised when subsequent billings are received, payments are made, billing matters are researched and resolved, tariffed billing periods lapse, or when disputed charges are resolved. We had no significant favorable or unfavorable adjustments in the first quarter.

#### *Cable Services Segment Revenues and Cost of Sales and Services*

Cable services segment revenues increased 1.9% to \$23.9 million and average gross revenue per average basic subscriber per month remained steady in the second quarter as compared to the first quarter. Programming services revenues increased 1.6% to \$18.5 million in second quarter resulting from the following:

- Basic subscribers served increased approximately 900 to approximately 137,200 at June 30, 2003 as compared to March 31, 2003,
- Homes passed increased approximately 2,000, a 1.0% increase from March 31, 2003. New facility construction efforts in second quarter 2003 resulted in approximately 1,000 additional homes passed

and a review of homes passed in the system acquired from Rogers American Cablesystems, Inc. resulted in approximately 1,000 additional homes passed,

- Effective February 2003, we increased rates charged for certain cable services and premium packages in six communities, including three of the state's four largest population centers Anchorage, Fairbanks and Juneau. Rates increased approximately 4% for those customers who experienced an adjustment, and
- Digital subscriber counts increased 1.7% to approximately 30,700 at June 30, 2003 as compared to March 31, 2003.

Cable programming services revenues have historically been highest in the winter months because consumers spend more time at home and tend to watch more television during these months.

The cable services segment's share of cable modem revenue (offered through our Internet services segment) increased \$215,000 to \$2.7 million in second quarter due to an increased number of cable modems deployed.

Cable services cost of sales and services decreased 1.3% to \$6.4 million in the second quarter as compared to the first quarter. Cable services cost of sales and services as a percentage of cable services segment revenues, which is less as a percentage of revenues than are local access and Internet services cost of sales and services, decreased from 27.6% in the first quarter to 26.7% in the second quarter. The decrease is primarily due to a \$182,000 favorable adjustment to cable services cost of sales and services after completion of audits by certain cable programming service vendors.

#### *Local Access Services Segment Revenues and Cost of Sales and Services*

Local access services segment revenues increased 9.7% in the second quarter to \$9.2 million primarily due to increased lines in service in the second quarter and a adjustment to an intrastate carrier common line customer account in the first quarter. At June 30, 2003 an estimated 101,900 lines were in service as compared to approximately 98,900 lines in service at March 31, 2003.

Local access services segment cost of sales and services increased \$214,000 to \$5.9 million in the second quarter. Local access services segment cost of sales and services as a percentage of local access services segment revenues decreased from 67.0% in the first quarter to 63.4% in the second quarter. The decrease in cost of sales and services as a percentage of local access services segment revenues is due to the following:

- The build-out of our facilities resulting in an increased number of access lines provisioned on our own facilities, UNE loop and UNE platform has resulted in decreased cost of sales and services and increased interstate and intrastate access revenue, and
- Further economies of scale and more efficient network utilization as the number of local access services subscribers and resulting revenues increase.

The decrease is partially off-set by decreased network access services revenues from other carriers as the number of customers purchasing both long-distance and local access services from us increases.

The local access services segment operating results are negatively effected by the allocation of the benefit of access cost savings to the long-distance services segment. If the local access services segment received credit for the access charge reductions recorded by the long distance services segment, the local access services segment operating results would have improved by approximately \$1.7 million and the long distance services segment operating results would have been reduced by an equal amount in the second quarter. Avoided access charges totaled approximately \$1.8 million in the first quarter.

#### *Internet Services Segment Revenues and Cost of Sales and Services*

Total Internet services segment revenues increased \$200,000 to \$4.8 million in the second quarter primarily due to the \$172,000 increase in Internet services segment's allocable share of cable modem revenues to \$2.2

million in the second quarter as compared to the first quarter. The increase in cable modem revenues is primarily due to growth in the number of cable modems deployed. Cable modem subscribers increased from approximately 38,600 at March 31, 2003 to approximately 40,500 at June 30, 2003.

We reported a total of 71,600 Internet subscribers at March 31, 2003. This subscriber count was based upon the total number of active dial-up subscribers at March 31, 2003. As discussed above, not all cable modem subscribers paying for a dial-up plan have activated their dial-up service. When we first started selling cable modem service it was packaged in a way that almost all cable modem subscribers were also dial up subscribers. As we introduced new packages and plans and started promoting our new cable modem LiteSpeed service the number of cable modem subscribers without a dial up plan increased substantially. An internal review during the second quarter of 2003 revealed that these subscriber counts had risen substantially enough that they should be reported separately. In future quarters we will report Internet subscribers in the format described above.

Internet services cost of sales and services increased \$18,000 in the second quarter to \$1.4 million, and as a percentage of Internet services revenues, totaled 29.7% and 30.6% in the second and first quarters, respectively.

#### *All Other Revenues and Costs of Sales and Services*

All Other revenues decreased \$1.4 million to \$6.5 million in the second quarter primarily due to sales of product to two customers in the first quarter.

All Other costs of sales decreased \$1.3 million to \$3.4 million in the second quarter, and as a percentage of All Other revenues, totaled 52.5% and 59.5% in the second and first quarters, respectively. The decrease in All Other costs of sales and services as a percentage of All Other revenues is primarily due to the following:

- A \$140,000 favorable adjustment in the second quarter due to a revision of an estimate of a previously unbilled cost of sales and service upon receipt of the invoice, and
- Sales of product to two customers in first quarter which have a higher costs of sales as a percentage of revenues than do managed services.

#### *Selling, General and Administrative Expenses*

Selling, general and administrative expenses increased 3.9% to \$34.3 million in the second quarter as compared to the first quarter. As a percentage of revenues, selling, general and administrative expenses were 35.8% and 35.6% in the second and first quarters, respectively.

#### *Bad Debt Expense*

Bad debt expense increased \$205,000 to \$802,000 in the second quarter as compared to the first quarter. As a percentage of total revenues, second and first quarter bad expense was 0.8% and 0.6%, respectively.

#### *Depreciation, Amortization and Accretion Expense*

Depreciation, amortization and accretion expense decreased 5.2% to \$12.8 million in second quarter as compared to first quarter due to several individually insignificant decreases in depreciation and amortization expense.

#### *Other Expense, Net*

Other expense, net of other income, decreased \$463,000 in the second quarter to \$9.6 million due to the amendment of our Senior Facility in April 2003 which extended the final maturity date from two years to five years. The extension resulted in an increased amortization period for deferred loan costs on our amended Senior Facility which began in the second quarter.

### *Net Income*

We reported net income of \$4.8 million for the second quarter as compared to net income of \$2.6 million for the first quarter. The increase is primarily due to increased revenues without a corresponding increase in cost of sales and services due to a refund in the long distance services segment and favorable cost of sales and services adjustments in the long distance and cable services segments and All Other Services in second quarter, as previously described.

The increased net income in second quarter as compared to first quarter is partially off-set by a \$2.3 million refund in the first quarter as previously described. Additionally, first quarter net income was decreased by the implementation of SFAS No. 143 on January 1, 2003 resulting in a cumulative effect of an accounting change, net of income tax benefit of \$367,000, of \$544,000.

### **Liquidity and Capital Resources**

Cash flows from operating activities totaled \$31.6 million in 2003 as compared to \$29.9 million in 2002. The increase in 2003 is primarily due to increased cash flow in 2003 from some of our segments, a \$2.3 million refund from a local exchange carrier in respect of its earnings that exceeded regulatory requirements, and a \$861,000 refund from an intrastate access cost pool that previously overcharged us for access services. Uses of cash during 2003 included \$17.4 million of expenditures for property and equipment, including construction in progress, principal payments on long-term debt and capital lease obligations of \$3.6 million, payment of \$2.6 million in fees associated with the original and amended Senior Facility, payment of preferred stock dividends of \$1.0 million and payment of a \$721,000 deposit on a workers' compensation stop-loss policy.

Net receivables increased \$7.4 million from December 31, 2002 to June 30, 2003 primarily due to an increase in:

- Trade receivables for broadband services provided to hospitals and health clinics, and
- Trade receivables for telecommunication services provided to certain customers. The accounts receivable for these customers were subsequently paid in July 2003.

Working capital totaled \$317,000 at June 30, 2003, a \$3.9 million decrease as compared to \$4.2 million at December 31, 2002. The decrease is primarily attributed to classification of \$20.0 million of our Senior Facility as current maturities of long-term debt as of June 30, 2003, upon the April 22, 2003 amendment described below.

The decrease in working capital was partially off-set by:

- A \$6.0 million increase in our cash balance at June 30, 2003 and a \$4.4 million decrease in accounts payable at June 30, 2003 as compared to December 31, 2002, primarily due to decreased capital expenditures during the six months ended June 30, 2003, and
- A \$7.4 million increase in net receivables at June 30, 2003 as compared to December 31, 2002 as previously described.

On April 22, 2003 we amended our \$225.0 million Senior Facility. The amendment provides for the followings changes:

- The final maturity date has been extended to October 31, 2007,
- We may fund capital expenditures, including construction or acquisition of additional fiber optic cable system capacity, through our own cash flow or by draws on the revolving credit facility of the Senior Facility not to exceed \$25.0 million, and
- The definition of Excess Cash Flow has been changed to the amount by which earnings before interest, taxes, depreciation, and amortization exceeds certain fixed charges as defined in the Senior

Facility agreement plus one-time fiber sales to the extent such fiber sales are not included in earnings before interest, taxes, depreciation, and amortization.

The amendment requires us to prepay the term loan as follows (amounts in thousands):

<u>Date</u>	<u>Amount</u>
Quarterly from September 30, 2003 to December 31, 2004	\$ 5,000
Quarterly from March 31, 2005 to December 31, 2005	\$ 6,000
Quarterly from March 31, 2006 to December 31, 2006	\$ 8,000
Quarterly from March 31, 2007 to September 30, 2007	\$ 10,000

The remaining balance of the term loan will be payable in full on October 31, 2007.

Under the amended Senior Facility capital expenditures, other than those incurred to build or acquire additional fiber optic cable system capacity, in any of the years ended December 31, 2003, 2004, 2005 and 2006 may not exceed:

- \$25.0 million, plus
- 100% of any Excess Cash Flow during the applicable period less certain permitted investments of up to \$5.0 million during the applicable period.

Under the amended Senior Facility we may not allow the ratio of total indebtedness to annualized operating cash flow to be greater than:

<u>Period</u>	<u>Ratio</u>
April 22, 2003 through December 30, 2003	4.25:1
December 31, 2003 through December 30, 2004	4.00:1
December 31, 2004 through December 30, 2005	3.75:1
December 31, 2005 through June 29, 2006	3.50:1
June 30, 2006 through June 29, 2007	3.25:1
June 30, 2007 through September 29, 2007	3.00:1
September 30, 2007 through October 31, 2007	2.75:1

Under the amended Senior Facility we may not allow the ratio of senior secured indebtedness to annualized operating cash flow to be greater than:

<u>Period</u>	<u>Ratio</u>
April 22, 2003 through December 30, 2004	2.00:1
December 31, 2004 through September 29, 2006	1.75:1
September 30, 2006 through June 29, 2007	1.50:1
June 30, 2007 through September 29, 2007	1.25:1
September 30, 2007 through October 31, 2007	1.00:1

Under the amended Senior Facility we must either have repaid in full or successfully refinanced our Senior Notes by February 1, 2007.

In connection with the amendment of the Senior Facility, we paid bank fees and other expenses of approximately \$2,379,000 during the six months ended June 30, 2003 which will be charged to Amortization of Loan and Senior Notes Fees over the life of the amended agreement.

The term loan is fully drawn and we have a \$3.0 million letter of credit, which leaves \$47.0 million available at June 30, 2003 to draw under the revolving credit facility if needed. In April 2003, we made a \$2.7 million principal payment on the revolving credit facility.

We were in compliance with all loan covenants at June 30, 2003.

Our semi-annual Senior Notes interest payment of \$8.8 million was paid in February 2003 out of existing cash balances. Our next Senior Notes interest payment of \$8.8 million is due August 1, 2003 and will be paid out of existing cash balances.

Our expenditures for property and equipment, including construction in progress, totaled \$17.4 million and \$36.2 million during the six months ended June 30, 2003 and 2002, respectively. Our capital expenditures requirements are largely success driven and are a result of the progress we are making in the marketplace. We expect our 2003 expenditures for property and equipment for our core operations, including construction in progress and excluding the new fiber system construction costs described below, to total \$40 million to \$55 million, depending on available opportunities and the amount of cash flow we generate during 2003.

We have begun work on the construction of a \$50 million fiber optic cable system connecting Seward, Alaska and Warrenton, Oregon, with leased backhaul facilities to connect it to our switching and distribution centers in Anchorage, Alaska and Seattle, Washington. The 1,544-statute mile cable has a total design capacity of 960 Gigabits per second access speed and is planned to be operational by May 2004. The cable will complement our existing fiber optic cable between Whittier, Alaska and Seattle, Washington. The two cables will provide physically diverse backup to each other in the event of an outage. We expect to fund construction of the fiber optic cable system through our operating cash flows and, to the extent necessary, with draws on our Senior Facility.

Planned capital expenditures over the next five years include those necessary for continued expansion of our long-distance, local exchange and Internet facilities, supplementation of our existing network backup facilities, continuing development of our Personal Communication Services, or PCS, network, digital local phone service, and upgrades to our cable television plant.

The financial, credit and economic impacts of MCI's July 2002 bankruptcy filing on the industry in general and on us in particular are not yet fully understood and are not predictable. See Long Distance Overview for a discussion of the settlement of the uncollected amounts due from MCI.

We believe that payment for services provided to MCI subsequent to their bankruptcy filing date will continue to be made timely, consistent with our status in MCI's filing as a key service provider or utility to MCI.

A conversion of MCI's bankruptcy petition to Chapter 7, or a migration of MCI's traffic off our network without it being replaced by other common carriers that interconnect with our network, could have a materially adverse impact on our financial position, results of operations and liquidity.

Dividends accrued on our Series B preferred stock are payable at the semi-annual payment dates of April 30 and October 31 of each year. We paid the \$722,000 dividend due on April 30, 2003 in cash. Our next Series B preferred stock dividend is due October 31, 2003.

Dividends accrued on our Series C preferred stock are payable in cash quarterly. Our next Series C preferred stock dividend of approximately \$150,000 is due September 30, 2003.

The long-distance, local access, cable, Internet and wireless services industries continue to experience substantial competition, regulatory uncertainty, and continuing technological changes. Our future results of operations will be affected by our ability to react to changes in the competitive and regulatory environment and by our ability to fund and implement new or enhanced technologies. We are unable to determine how competition, economic conditions, and regulatory and technological changes will affect our ability to obtain financing.

The telecommunications industry in general is depressed due to high levels of competition in the long-distance market resulting in pressures to reduce prices, an oversupply of long-haul capacity, excessive debt loads, several high-profile company failures and potentially fraudulent accounting practices by some companies. Our ability to obtain new debt under acceptable terms and conditions in the future may be diminished as a result.

We believe that we will be able to meet our current and long-term liquidity and capital requirements, fixed charges and preferred stock dividends through our cash flows from operating activities, existing cash, cash equivalents, short-term investments, credit facilities, and other external financing and equity sources. Should cash flows be insufficient to support additional borrowings and principal payments scheduled under our existing credit facilities, capital expenditures will likely be reduced.

#### **New Accounting Standards**

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities". SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003, except for certain provisions that relate to SFAS No. 133 Implementation Issues which should continue to be applied in accordance with their respective effective dates, and for hedging relationships designated after June 30, 2003. We do not expect implementation of SFAS No. 149 to have a material effect on our results of operations, financial position and cash flows.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". SFAS No. 150 establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances). Many of those instruments were previously classified as equity. Some of the provisions of this SFAS No. 150 are consistent with the current definition of liabilities in FASB Concepts Statement No. 6, "Elements of Financial Statements". The remaining provisions of SFAS No. 150 are consistent with the FASB's proposal to revise the current definition of liabilities to encompass certain obligations that a reporting entity can or must settle by issuing its own equity shares, depending on the nature of the relationship established between the holder and the issuer. We do not expect implementation of SFAS No. 150 to have a material effect on our results of operations, financial position and cash flows.

In January 2003 the FASB issued FIN No. 46, "Consolidation of Variable Interest Entities". This Interpretation of Accounting Research Bulletin No. 51, "Consolidated Financial Statements", addresses consolidation by business enterprises of variable interest entities, which have one or both of the following characteristics:

1. The equity investment at risk is not sufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, which is provided through other interests that will absorb some or all of the expected losses of the entity.
2. The equity investors lack one or more of the following essential characteristics of a controlling financial interest:
  - a. The direct or indirect ability to make decisions about the entity's activities through voting rights or similar rights
  - b. The obligation to absorb the expected losses of the entity if they occur, which makes it possible for the entity to finance its activities
  - c. The right to receive the expected residual returns of the entity if they occur, which is the compensation for the risk of absorbing the expected losses.

We do not expect implementation of FIN No. 46 to have a material effect on our results of operations, financial position and cash flows.

### **Critical Accounting Policies**

Our accounting and reporting policies comply with accounting principles generally accepted in the United States of America. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions. The financial position and results of operations can be affected by these estimates and assumptions, which are integral to understanding reported results. Critical accounting policies are those policies that management believes are the most important to the portrayal of the Company's financial condition and results, and require management to make estimates that are difficult, subjective or complex. Most accounting policies are not considered by management to be critical accounting policies. Several factors are considered in determining whether or not a policy is critical in the preparation of financial statements. These factors include, among other things, whether the estimates are significant to the financial statements, the nature of the estimates, the ability to readily validate the estimates with other information including third parties or available prices, and sensitivity of the estimates to changes in economic conditions and whether alternative accounting methods may be utilized under accounting principles generally accepted in the United States of America. For all of these policies, management cautions that future events rarely develop exactly as forecast, and the best estimates routinely require adjustment. Management has discussed the development and the selection of critical accounting policies with the Company's Audit Committee.

Those policies considered to be critical accounting policies for the three and six months ended June 30, 2003 are described below.

- We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. We base our estimates on the aging of our accounts receivable balances, financial health of specific customers, and our historical write-off experience, net of recoveries. If the financial condition of our customers were to deteriorate or if they are unable to emerge from reorganization proceedings, resulting in an impairment of their ability to make payments, additional allowances may be required. If their financial condition improves or they emerge successfully from reorganization proceedings, allowances may be reduced. Such allowance changes could have a material effect on our consolidated financial condition and results of operations.
- We record all assets and liabilities acquired in purchase acquisitions, including goodwill and other intangibles, at fair value as required by SFAS 141. Goodwill and indefinite-lived assets such as our

cable segment franchise agreements are no longer amortized but are subject, at a minimum, to annual tests for impairment. Other intangible assets are amortized over their estimated useful lives using the straight-line method, and are subject to impairment if events or circumstances indicate a possible inability to realize the carrying amount. The initial goodwill and other intangibles recorded and subsequent impairment analysis requires management to make subjective judgments concerning estimates of how the acquired asset will perform in the future using a discounted cash flow analysis. Additionally, estimated cash flows may extend beyond ten years and, by their nature, are difficult to determine over an extended timeframe. Events and factors that may significantly affect the estimates include, among others, competitive forces, customer behaviors and attrition, changes in revenue growth trends, cost structures and technology, and changes in discount rates, performance compared to peers, material and ongoing negative economic trends, and specific industry or market sector conditions. In determining the reasonableness of cash flow estimates, we review historical performance of the underlying asset or similar assets in an effort to improve assumptions utilized in our estimates. In assessing the fair value of reportable operating segments, we may consider other information to validate the reasonableness of our valuations including public market comparables, multiples of recent mergers and acquisitions of similar businesses and third-party assessments. These evaluations could result in a change in useful lives in future periods and could result in write-down of the value of intangible assets. Because of the significance of the identified intangible assets and goodwill to our consolidated balance sheet, the annual impairment analysis will be critical. Any changes in key assumptions about the business and its prospects, or changes in market conditions or other externalities, could result in an impairment charge and such a charge could have a material adverse effect on our consolidated financial condition and results of operations. Refer to Note 3 in the accompanying *Notes to Interim Condensed Consolidated Financial Statements* for additional information regarding intangible assets.

- We estimate unbilled long-distance segment cost of sales based upon minutes of use carried through our network and established rates. We estimate unbilled costs for new circuits and services, and when network changes occur that result in traffic routing changes or a change in carriers. Carriers that provide service to us regularly change their networks which can lead to new, revised or corrected billings. Such estimates are revised or removed when subsequent billings are received, payments are made, billing matters are researched and resolved, tariffed billing periods lapse, or when disputed charges are resolved. Revisions to previous estimates could either increase or decrease costs in the year in which the estimate is revised which could have a material effect on our consolidated financial condition and results of operations.
- Our income tax policy provides for deferred income taxes to show the effect of temporary differences between the recognition of revenue and expenses for financial and income tax reporting purposes and between the tax basis of assets and liabilities and their reported amounts in the financial statements in accordance with SFAS No. 109, "Accounting for Income Taxes." We have recorded deferred tax assets of approximately \$79.0 million associated with income tax net operating losses that were generated from 1990 to 2003, and that expire from 2005 to 2023. Pre-acquisition income tax net operating losses associated with acquired companies are subject to additional deductibility limits. We have recorded deferred tax assets of approximately \$1.9 million associated with alternative minimum tax credits that do not expire. Significant management judgment is required in developing our provision for income taxes, including the determination of deferred tax assets and liabilities and any valuation allowances that may be required against the deferred tax assets. In conjunction with certain 1996 acquisitions, we determined that approximately \$20 million of the acquired net operating losses would not be utilized for income tax purposes, and elected with our December 31, 1996 income tax returns to forego utilization of such acquired losses. Deferred tax assets were not recorded associated with the foregone losses and, accordingly, no valuation allowance was provided. We have not recorded a valuation allowance on the deferred tax assets as of June 30, 2003 based on management's belief that future reversals of existing taxable temporary differences and estimated future taxable

income exclusive of reversing temporary differences and carryforwards, will, more likely than not, be sufficient to realize the benefit of these assets over time. In the event that actual results differ from these estimates or if our historical trends change, we may be required to record a valuation allowance on deferred tax assets, which could have a material adverse effect on our consolidated financial condition and results of operations.

Other significant accounting policies, not involving the same level of measurement uncertainties as those discussed above, are nevertheless important to an understanding of the financial statements. Policies related to revenue recognition and financial instruments require difficult judgments on complex matters that are often subject to multiple sources of authoritative guidance. Certain of these matters, including but not limited to the requirement to account for the market value of stock options as compensation expense, are among topics currently under reexamination by accounting standards setters and regulators. Although no specific conclusions reached by these standard setters appear likely to cause a material change in our accounting policies, outcomes cannot be predicted with confidence. A complete discussion of our significant accounting policies can be found in Note 1 in the *Notes to Consolidated Financial Statements* included in our December 31, 2002 Form 10-K. A condensed discussion of our significant accounting policies can be found in Note 1 in the accompanying *Notes to Interim Condensed Consolidated Financial Statements*.

### **Geographic Concentration and the Alaska Economy**

We offer voice and data telecommunication and video services to customers primarily throughout Alaska. Because of this geographic concentration, growth of our business and of our operations depends upon economic conditions in Alaska. The economy of Alaska is dependent upon the natural resource industries, and in particular oil production, as well as investment earnings, tourism, government, and United States military spending. Any deterioration in these markets could have an adverse impact on us. In fiscal 2002 the State's actual results indicate that Alaska's oil revenues and federal funding supplied 47% and 43%, respectively, of the state's total revenues. All of the federal funding is dedicated for specific purposes, leaving oil revenues as the primary funding source of general operating expenditures. In fiscal 2003 state economists forecast that Alaska's federal funding and oil revenues will supply 51% and 44%, respectively, of the state's total projected revenues.

The volume of oil transported by the TransAlaska Oil Pipeline System over the past 20 years has been as high as 2.0 million barrels per day in fiscal 1988. Production has been declining over the last several years with an average of 1.003 million barrels produced per day in fiscal 2002. The state forecasts the production of 0.994 million barrels per day in fiscal 2003, and a production rate slightly above 1.0 million barrels per day starting in fiscal 2009. The state attributes the production rate increase to future development of recent discoveries in the National Petroleum Reserve Alaska and other new fields.

Market prices for North Slope oil averaged \$21.78 in fiscal 2002 and are forecasted to average \$28.14 in fiscal 2003. State economists forecast the average price of North Slope oil to decline to \$25.28 in fiscal 2004. The closing price per barrel was \$30.31 on July 21, 2003. To the extent that actual oil prices vary materially from the state's projected prices the state's projected revenues and deficits will change. Every \$1 change in the price of oil results in a \$50.0 to \$60.0 million change in the state's revenue. The production policy of the Organization of Petroleum Exporting Countries and its ability to continue to act in concert represents a key uncertainty in the state's revenue forecast.

The State of Alaska maintains the Constitutional Budget Reserve Fund that is intended to fund budgetary shortfalls. If the state's current projections are realized, the Constitutional Budget Reserve Fund will be depleted in 2006. The date the Constitutional Budget Reserve Fund is depleted is highly influenced by the price of oil. If the fund is depleted, aggressive state action will be necessary to increase revenues and reduce spending in order to balance the budget. The governor of the State of Alaska and the Alaska legislature continue to pursue cost cutting and revenue enhancing measures. Through a combination of revenue enhancements and reductions in spending the governor of the State of Alaska and the State legislature

approved a fiscal 2004 budget which is projected to spend approximately \$380 million of the Constitutional Budget Reserve Fund.

In 2003 the Alaska Legislature passed and the Governor signed legislation that extended the life of the RCA until 2007.

Tourism, air cargo, and service sectors have helped offset the prevailing pattern of oil industry downsizing that has occurred during much of the last several years. Funds from federal sources totaling \$2.4 billion are expected to be distributed to the State of Alaska for highways and other federally supported projects in fiscal 2003.

Should new oil discoveries or developments not materialize or the price of oil become depressed, the long term trend of continued decline in oil production from the Prudhoe Bay area is inevitable with a corresponding adverse impact on the economy of the state, in general, and on demand for telecommunications and cable television services, and, therefore, on us, in particular. In the past year, there has been a renewed effort to allow exploration and development in the Arctic National Wildlife Refuge ("ANWR"). The U.S. Energy Information Agency estimates it could take nine years to begin oil field drilling after approval of ANWR exploration.

Deployment of a natural gas pipeline from the State of Alaska's North Slope to the Lower 48 states has been proposed to supplement natural gas supplies. A competing natural gas pipeline through Canada has also been proposed. The economic viability of a natural gas pipeline depends upon the price of and demand for natural gas. Either project could have a positive impact on the State of Alaska's revenues and the Alaska economy. According to their public comments, neither Exxon Mobil, BP nor Conoco Phillips, Alaska's large natural gas owners, believe either natural gas pipeline makes financial sense based upon their preliminary analysis, though BP and Conoco Phillips have proposed certain federal income tax incentives that would take effect if the price for Alaska natural gas goes below a certain level. The governor of the State of Alaska and certain natural gas transportation companies continue to support a natural gas pipeline from Alaska's North Slope by trying to reduce the project's costs and by advocating for federal tax incentives to further reduce the project's costs.

Development of the ballistic missile defense system project may have a significant impact on Alaskan telecommunication requirements and the Alaska economy. The proposed system would be a fixed, land-based, non-nuclear missile defense system with a land and space based detection system capable of responding to limited strategic ballistic missile threats to the United States. The preferred alternative is deployment of a system with up to 100 ground-based interceptor silos and battle management command and control facilities at Fort Greely, Alaska.

The U.S. Army Corps of Engineers awarded a construction contract in 2002 for test bed facilities. The contract is reported to contain basic requirements and various options that could amount to \$250 million in construction, or possibly more, if all items are executed. Site preparation has been underway at Fort Greely since August of 2001 and construction began on the Fort Greely test bed shortly after the June 15, 2002 groundbreaking. The test bed is due to be operational by September 30, 2004.

We have, since our entry into the telecommunication marketplace, aggressively marketed our services to seek a larger share of the available market. The customer base in Alaska is limited, however, with a population of approximately 644,000 people. The State of Alaska's population is distributed as follows:

- 42% are located in the Municipality of Anchorage,
- 13% are located in the Fairbanks North Star Borough,
- 10% are located in the Matanuska-Susitna Borough,
- 5% are located in the City and Borough of Juneau, and

- The remaining 30% are located in other communities across the State of Alaska.

No assurance can be given that the driving forces in the Alaska economy, and in particular, oil production, will continue at appropriate levels to provide an environment for expanded economic activity.

No assurance can be given that oil companies doing business in Alaska will be successful in discovering new fields or further developing existing fields which are economic to develop and produce oil with access to the pipeline or other means of transport to market, even with a reduced level of royalties. We are not able to predict the effect of changes in the price and production volumes of North Slope oil on Alaska's economy or on us.

### **Seasonality**

Long-distance revenues (primarily those derived from our other common carrier customers) have historically been highest in the summer months because of temporary population increases attributable to tourism and increased seasonal economic activity such as construction, commercial fishing, and oil and gas activities. Cable television revenues, on the other hand, are higher in the winter months because consumers spend more time at home and tend to watch more television during these months. Local access and Internet services are not expected to exhibit significant seasonality. Our ability to implement construction projects is also hampered during the winter months because of cold temperatures, snow and short daylight hours.

### **Inflation**

We do not believe that inflation has a significant effect on our operations.

### **Schedule of Certain Known Contractual Obligations**

The following table details future projected payments associated with our certain known contractual obligations as of December 31, 2002, the date of our most recent fiscal year-end balance sheet. Our schedule of certain known contractual obligations has been updated to reflect the April 22, 2003 amendment of our Senior Facility and to include certain purchase obligations.

	<b>Payments Due by Period</b>				
	<b>Total</b>	<b>Less than 1 Year</b>	<b>1 to 3 Years</b>	<b>4 to 5 Years</b>	<b>More Than 5 Years</b>
	(Amounts in thousands)				
Long-term debt	\$ 357,700	15,000	47,000	295,700	---
Interest on long-term debt	87,750	17,550	35,100	35,100	---
Capital lease obligations, including interest	68,943	5,115	19,845	18,536	25,447
Operating lease commitments	67,673	11,780	18,607	12,878	24,408
Redeemable preferred stocks	27,298	---	10,150	---	17,148
Purchase obligations	39,136	21,549	17,587	---	---
Total contractual obligations	<u>\$ 648,500</u>	<u>70,994</u>	<u>148,289</u>	<u>362,214</u>	<u>67,003</u>

Purchase obligations include our fiber optic cable system construction commitment of \$35.4 million as further described in note 6 to the *Notes to Interim Condensed Consolidated Financial Statements* included in Part I, Item 1 of this report. The contract associated with this commitment is non-cancelable.

For long-term debt included in the above table, we have included principal payments on our Senior Facility and on our Senior Notes. Interest on amounts outstanding under our Senior Facility is based on variable rates and therefore the amount is not determinable. Our Senior Notes require semi-annual interest payments of approximately \$8.78 million through 2007. For a discussion of our long-term debt, see note 6 to the *Notes to Consolidated Financial Statements* included in Part II of our December 31, 2002 Form 10-K.

For a discussion of our capital and operating leases, see note 12 to the *Notes to Consolidated Financial Statements* included in Part II of our December 31, 2002 Form 10-K.

We have included only the maturity redemption amount on our Series B and C preferred stock (cash dividends are excluded). Our Series B preferred stock is convertible at \$5.55 per share into GCI Class A common stock. Through April 30, 2003, dividends are payable semi-annually at the rate of 8.5%, plus accrued but unpaid dividends, at our option, in cash or in additional fully-paid shares of Series B preferred stock. The dividend due on April 30, 2003 was paid in cash. Dividends earned after April 30, 2003, are payable semi-annually in cash only. Mandatory redemption is required 12 years from the date of closing. Our Series C preferred stock is convertible at \$12 per share into GCI Class A common stock, is non-voting, and pays a 6% per annum quarterly cash dividend. We may redeem the Series C preferred stock at any time in whole but not in part. Mandatory redemption is required at any time after the fourth anniversary date at the option of holders of 80% of the outstanding shares of the Series C preferred stock. For more information about our redeemable preferred stock, see note 1(e) to the *Notes to Consolidated Financial Statements* included in Part II of our December 31, 2002 Form 10-K.

#### **Audit Committee**

The Audit Committee, composed entirely of independent directors, meets periodically with our independent auditors and management to review the Company's financial statements and the results of audit activities. The Audit Committee, in turn, reports to the Board of Directors on the results of its review and recommends the selection of independent auditors.

The Audit Committee has approved the independent auditor to provide the following services:

- Audit (audit of financial statements filed with the SEC, quarterly reviews, comfort letters, consents, review of registration statements, accounting consultations); and
- Audit-related (employee benefit plan audits and accounting consultation on proposed transactions).

## **PART I. ITEM 3.**

### ***Quantitative and Qualitative Disclosures About Market Risk***

We are exposed to various types of market risk in the normal course of business, including the impact of interest rate changes. We do not hold derivatives for trading purposes.

Our Senior Facility carries interest rate risk. Amounts borrowed under this Agreement bear interest at Libor plus 6.5%. Should the Libor rate change, our interest expense will increase or decrease accordingly. On September 21, 2001, we entered into an interest rate swap agreement to convert \$25.0 million of variable interest rate debt to 3.98% fixed rate debt plus applicable margin. As of June 30, 2003, we have borrowed \$175.0 million of which \$150.0 million is subject to interest rate risk. On this amount, a 1% increase in the interest rate would cost us \$1,500,000 in additional gross interest cost on an annualized basis.

Our Satellite Transponder Capital Lease carries interest rate risk. Amounts borrowed under this Agreement bear interest at Libor plus 3.25%. Should the Libor rate change, our interest expense will increase or decrease accordingly. As of June 30, 2003, we have borrowed \$44.2 million subject to interest rate risk. On this amount, a 1% increase in the interest rate would cost us \$442,000 in additional gross interest cost on an annualized basis.

**PART I.**  
**ITEM 4.**

*Controls and Procedures*

**Evaluation of disclosure controls and procedures**

Within the 90 days prior to the date of this report, we carried out an evaluation of the effectiveness of the design and operation of our “disclosure controls and procedures” (as defined in the Securities Exchange Act of 1934 (“Exchange Act”) Rules 13a-14(c) and 15d-14(c)) under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management to allow timely decisions regarding required disclosure.

**Changes in Internal Controls**

There were no significant changes in our internal controls or, to our knowledge, in other factors that could significantly affect our disclosure controls and procedures subsequent to the date we carried out this evaluation.

We may enhance, modify, and supplement internal controls and disclosure controls and procedures based on experience.

**PART II. OTHER INFORMATION**  
**ITEM 1. LEGAL PROCEEDINGS**

Information regarding pending legal proceedings to which we are a party is included in note 6 to the *Interim Condensed Consolidated Financial Statements* and is incorporated herein by reference.

**PART II.**  
**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

- (a) Date of the meeting: June 5, 2003  
Purpose of meeting: Annual shareholders meeting
- (b) Name of each director elected at the meeting and the name of each other director whose term of office as a director continued after the meeting:

<u>Name</u>	<u>Votes for</u>	<u>Votes withheld</u>
Stephen M. Brett	67,434,190	4,645,352
Ronald A. Duncan	59,281,403	12,798,139
Stephen R. Mooney	61,035,789	11,043,753
Stephen A. Reinstadtler	68,046,597	4,032,945

Directors, in addition to those listed above, whose term of office as director continued after the meeting:

Donne F. Fisher  
William P. Glasgow  
James M. Schneider

(c) Other matters voted upon:

None.

(d) Not applicable

**PART II.**  
**ITEM 6.**

**EXHIBITS AND REPORTS ON FORM 8-K**

(a) Exhibits -

<b>Exhibit No.</b>	<b>Description</b>
10.108	Bonus Agreement between General Communication, Inc. and Wilson Hughes
10.109	Eighth Amendment to Contract for Alaska Access Services between General Communication, Inc. and its wholly owned subsidiary GCI Communication Corp., and MCI WorldCom Network Services, Inc. ♦
10.110	Settlement and Release Agreement between General Communication, Inc. and WorldCom, Inc.
99.36	Certifications Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
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♦	Certain information has been redacted from this document which we desire to keep undisclosed.
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(b) Reports on Form 8-K filed during the quarter ended June 30, 2003:

- On April 29, 2003, we filed a report on Form 8-K dated April 23, 2003 under Item 7 and 9 furnished pursuant to Item 12 which included a copy of our press release dated that same day reporting a summary description of our results of operations for the three month period ended March 31, 2003.
- On May 8, 2003, we filed a report on Form 8-K dated May 7, 2003 under Item 7 and 9 furnished pursuant to Item 12 which included a copy of our press release dated that same day reporting a detailed description of our results of operations for the three month period ended March 31, 2003.
- On May 9, 2003, we filed a report on Form 8-K/A dated May 9, 2003 under Item 7 and 9 furnished pursuant to Item 12 which included a correction of our press release dated May 7, 2003 reporting a detailed description of our results of operations for the three month period ended March 31, 2003.

## SIGNATURES

Pursuant to the requirements 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.

### GENERAL COMMUNICATION, INC.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
<u>/s/ Ronald A. Duncan</u> Ronald A. Duncan	President and Director (Principal Executive Officer)	<u>August 6, 2003</u>
<u>/s/ John M. Lowber</u> John M. Lowber	Senior Vice President, Chief Financial Officer, Secretary and Treasurer (Principal Financial Officer)	<u>August 6, 2003</u>
<u>/s/ Alfred J. Walker</u> Alfred J. Walker	Vice President, Chief Accounting Officer (Principal Accounting Officer)	<u>August 6, 2003</u>

SECTION 302 CERTIFICATION

I, Ronald A. Duncan, certify that:

1. I have reviewed this report on Form 10-Q of General Communication, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 6, 2003

/s/ Ronald A. Duncan

Ronald A. Duncan  
President and Director

SECTION 302 CERTIFICATION

I, John M. Lowber, certify that:

1. I have reviewed this report on Form 10-Q of General Communication, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and we have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 6, 2003

/s/ John M. Lowber  
John M. Lowber  
Senior Vice President, Chief Financial Officer,  
Secretary and Treasurer