

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q/A-2

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 1996.

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

FOR THE TRANSITION PERIOD FROM TO .

COMMISSION FILE NUMBER 1-13796

GRAY COMMUNICATIONS SYSTEMS, INC.
(Exact name of registrant as specified in its charter)

GEORGIA
(State or other jurisdiction of
incorporation or organization)

58-0285030
(I.R.S. Employer
Identification Number)

126 NORTH WASHINGTON ST., ALBANY, GEORGIA 31701
(Address of principal executive offices)
(Zip code)

(912) 888-9390
(Registrant's telephone number, including area code)

NOT APPLICABLE
(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 periods that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES /X/ NO / /

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practical date.

CLASS A COMMON STOCK, NO PAR VALUE

4,469,339 SHARES AS OF SEPTEMBER 9, 1996

CLASS B COMMON STOCK, NO PAR VALUE - NONE

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GRAY COMMUNICATIONS SYSTEMS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	DECEMBER 31, 1995	MARCH 31, 1996
CURRENT ASSETS		
Cash and cash equivalents.....	\$ 559,991	\$ 2,081,627
Trade accounts receivable, less allowance for doubtful accounts of \$450,000 and \$623,000, respectively.....	9,560,274	10,145,128
Recoverable income taxes.....	1,347,007	985,246
Inventories.....	553,032	231,964
Current portion of program broadcast rights.....	1,153,058	1,326,825
Other current assets.....	263,600	651,407
	-----	-----
Property and equipment.....	13,436,962	15,422,197
Less allowance for depreciation.....	37,618,893	40,505,148
	(20,601,819)	(21,406,793)
	-----	-----
Other assets	17,017,074	19,098,355
Deferred acquisition costs (includes \$910,000 and \$1,050,000 to Bull Run Corporation at December 31, 1995 and March 31, 1996, respectively) (Note C).....	3,330,481	1,951,164
Deferred loan costs (Note C).....	1,232,261	1,939,173
Goodwill and other intangibles (Note C).....	42,004,050	73,938,623
Other.....	1,219,650	1,195,139
	-----	-----
	47,786,442	79,024,099
	-----	-----
	\$ 78,240,478	\$ 113,544,651
	-----	-----
CURRENT LIABILITIES		
Trade accounts payable (includes \$670,000 and \$1,050,000 payable to Bull Run Corporation at December 31, 1995 and March 31, 1996, respectively).....	\$ 3,752,742	\$ 3,372,917
Accrued expenses.....	5,839,007	6,226,119
Current portion of program broadcast obligations.....	1,205,784	1,222,983
Current portion of long-term debt.....	2,861,672	1,516,325
	-----	-----
	13,659,205	12,338,344
Long-term debt (including a \$7,472,222 8% Note to Bull Run Corporation at March 31, 1996) (Notes C and D).....	51,462,645	84,396,637
Non-current liabilities.....	4,133,030	4,535,319
Commitments and contingencies (Notes C and E)		
Stockholders' equity (Notes B and D)		
Class A Common Stock, no par value; authorized 10,000,000 shares; issued 5,082,756 and 5,126,012 shares, respectively.....	6,795,976	9,862,594
Retained earnings.....	8,827,906	9,050,041
	-----	-----
	15,623,882	18,912,635
Treasury stock, 663,180 shares at cost.....	(6,638,284)	(6,638,284)
	-----	-----
	8,985,598	12,274,351
	-----	-----
	\$ 78,240,478	\$ 113,544,651
	-----	-----

See notes to condensed consolidated financial statements.

GRAY COMMUNICATIONS SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	THREE MONTHS ENDED MARCH 31	
	1995	1996
OPERATING REVENUES		
Broadcasting (net of agency commissions).....	\$ 8,349,661	\$ 11,449,645
Publishing.....	4,800,644	5,576,934
	-----	-----
	13,150,305	17,026,579
EXPENSES		
Broadcasting.....	5,589,776	7,309,865
Publishing.....	3,961,563	4,808,062
Corporate and administrative.....	492,951	775,586
Depreciation and amortization.....	878,749	1,395,254
Non-cash compensation paid in Class A Common Stock (Note B).....	236,158	60,000
	-----	-----
	11,159,197	14,348,767
Miscellaneous income.....	1,991,108	2,677,812
	43,313	63,514
	-----	-----
Interest expense.....	2,034,421	2,741,326
	1,376,464	2,229,115
	-----	-----
INCOME BEFORE INCOME TAXES.....	657,957	512,211
Income tax expense.....	254,000	201,000
	-----	-----
NET EARNINGS.....	\$ 403,957	\$ 311,211
	-----	-----
Average outstanding common shares.....	4,307,595	4,606,773
	-----	-----
NET EARNINGS PER COMMON SHARE.....	\$.09	\$.07
	-----	-----

See notes to condensed consolidated financial statements.

GRAY COMMUNICATIONS SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (UNAUDITED)

	CLASS A COMMON STOCK		TREASURY STOCK		RETAINED EARNINGS	TOTAL
	SHARES	AMOUNT	SHARES	AMOUNT		
Balance at December 31, 1995.....	5,082,756	\$ 6,795,976	(663,180)	\$ (6,638,284)	\$ 8,827,906	\$ 8,985,598
Net income for the three months ended March 31, 1996.....	0	0	0	0	311,211	311,211
Cash dividends (\$.02 per share)....	0	0	0	0	(89,076)	(89,076)
Issuance of Common Stock Warrants (Notes C and D).....	0	2,600,000	0	0	0	2,600,000
Issuance of Class A Common Stock:						
401(k) Plan.....	4,256	78,369	0	0	0	78,369
Directors stock plan.....	22,500	228,749	0	0	0	228,749
Non-qualified stock plan.....	16,500	159,500	0	0	0	159,500
Balance at March 31, 1996.....	5,126,012	\$ 9,862,594	(663,180)	\$ (6,638,284)	\$ 9,050,041	\$ 12,274,351

See notes to condensed consolidated financial statements.

GRAY COMMUNICATIONS SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	THREE MONTHS ENDED MARCH 31	
	1995	1996
OPERATING ACTIVITIES		
Net income.....	\$ 403,957	\$ 311,211
Items which did not use (provide) cash:		
Depreciation.....	584,988	848,427
Amortization of intangible assets.....	293,761	546,827
Amortization of program broadcast rights.....	401,838	646,820
Amortization of original issue discount on subordinated note.....	0	72,222
Payments for program broadcast rights.....	(481,311)	(661,603)
Compensation paid in Class A Common Stock.....	236,158	60,000
Supplemental employee benefits.....	(76,643)	(135,755)
Class A Common Stock contributed to 401(k) Plan.....	70,417	78,369
Deferred income taxes.....	91,000	343,850
(Gain) loss on disposal of assets.....	(725)	(20,406)
Changes in operating assets and liabilities:		
Receivables, inventories, and other current assets.....	687,323	1,550,389
Accounts payable and other current liabilities.....	(690,692)	(521,496)
NET CASH PROVIDED BY OPERATING ACTIVITIES.....	1,520,071	3,118,855
INVESTING ACTIVITIES		
Acquisition of newspaper business.....	(1,232,509)	0
Acquisition of television business.....	0	(34,300,713)
Purchases of property and equipment.....	(973,437)	(813,588)
Deferred acquisition costs.....	0	(931,623)
Proceeds from asset sales.....	1,293	113,297
Other.....	(164,563)	(80,188)
NET CASH USED IN INVESTING ACTIVITIES.....	(2,369,216)	(36,012,815)
FINANCING ACTIVITIES		
Dividends paid.....	(84,496)	(89,076)
Class A Common Stock transactions.....	0	388,249
Proceeds from borrowings of long-term debt.....	700,000	36,725,000
Payments on long-term debt.....	(33,652)	(2,608,577)
NET CASH PROVIDED BY FINANCING ACTIVITIES.....	581,852	34,415,596
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS.....	(267,293)	1,521,636
Cash and cash equivalents at beginning of period.....	558,520	559,991
CASH AND CASH EQUIVALENTS AT END OF PERIOD.....	\$ 291,227	\$ 2,081,627

See notes to condensed consolidated financial statements.

GRAY COMMUNICATIONS SYSTEMS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE A -- BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements of Gray Communications Systems, Inc. (the "Company") have been prepared in accordance with generally accepted accounting principles for interim financial information and instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month period ended March 31, 1996, are not necessarily indicative of the results that may be expected for the year ending December 31, 1996.

Certain amounts in the accompanying unaudited consolidated financial statements have been reclassified to conform to the 1996 format.

NOTE B -- EMPLOYMENT AGREEMENTS

During the quarter ended March 31, 1995, the Company awarded 150,000 shares of its Class A Common Stock to its former president and chief executive officer under his employment agreement. Compensation expense of approximately \$176,000 was recognized for these awards in the quarter ended March 31, 1995.

The Company has an employment agreement with its current President which provides for an award of 122,034 shares of Class A Common Stock if his employment with the Company continues until September 1999. Approximately \$60,000 of expense was recognized in the first quarter of each of 1995 and 1996 relating to this award and approximately \$1.2 million of expense will be recognized over the five-year period ending in 1999.

NOTE C -- BUSINESS ACQUISITIONS

The Company's acquisitions in 1995 and 1996 have been accounted for under the purchase method of accounting. Under the purchase method of accounting, the results of operations of the acquired businesses are included in the accompanying unaudited consolidated financial statements as of their respective acquisition dates. The assets and liabilities of acquired businesses are included based on an allocation of the purchase price.

PENDING ACQUISITIONS

In December 1995, as amended in March 1996, the Company entered into an asset purchase agreement to acquire (the "Phipps Acquisition") two CBS-affiliated stations, WCTV-TV ("WCTV") serving Tallahassee, Florida/Thomasville, Georgia and WKXT-TV ("WKXT") in Knoxville, Tennessee, a satellite broadcasting business and a paging business (collectively, the "Phipps Business"). The purchase price is estimated at approximately \$185.0 million. The Company's Board of Directors has agreed to pay Bull Run Corporation ("Bull Run"), a principal stockholder of the Company, a finder's fee equal to 1% of the proposed purchase price for services performed, of which \$1.05 million was due and included in accounts payable at March 31, 1996.

The consummation of the Phipps Acquisition, which is expected to occur by September 1996, is subject to approval by the appropriate regulatory agencies. In connection with the Phipps Acquisition, the Company is seeking approval from the Federal Communications Commission ("FCC") of the assignment of the television broadcast licenses for WCTV and WKXT. Current FCC regulations will require the Company to divest itself of WALB-TV ("WALB") in Albany, Georgia and WJHG-TV ("WJHG") in Panama City, Florida due to common ownership restrictions on stations with overlapping signals. In order to satisfy applicable FCC requirements, the Company, subject to FCC approval, intends to swap such assets for assets of one or more television stations of comparable value and with

NOTE C -- BUSINESS ACQUISITIONS (CONTINUED)

comparable broadcast cash flow in a transaction qualifying for deferred capital gains treatment under the "like-kind exchange" provision of Section 1031 of the Internal Revenue Code of 1986, as amended (the "Code"). If the Company is unable to effect such a swap on satisfactory terms within the time period granted by the FCC, the Company may transfer such assets to a trust with a view towards the trustee effecting a swap or sale of such assets. Any such trust arrangement would be subject to the approval of the FCC.

Condensed balance sheets of WALB and WJHG are as follows (in thousands):

	MARCH 31, 1996	
	WALB	WJHG
Current assets.....	\$ 1,667	\$ 855
Property and equipment.....	1,769	1,078
Other assets.....	76	3
Total assets.....	\$ 3,512	\$ 1,936
Current liabilities.....	\$ 1,127	\$ 428
Other liabilities.....	228	0
Stockholders' equity.....	2,157	1,508
Total liabilities and stockholders' equity.....	\$ 3,512	\$ 1,936

Condensed income statement data of WALB and WJHG are as follows (in thousands):

	WALB THREE MONTHS ENDED MARCH 31,		WJHG THREE MONTHS ENDED MARCH 31,	
	1995	1996	1995	1996
Broadcasting revenues.....	\$ 2,182	\$ 2,340	\$ 851	\$ 1,099
Expenses.....	1,190	1,242	802	949
Operating income.....	992	1,098	49	150
Other income.....	4	9	15	16
Income before income taxes.....	996	1,107	64	166
Net income.....	\$ 618	\$ 686	\$ 40	\$ 103

The Phipps Acquisition will be funded with a portion of the anticipated net proceeds of proposed public offerings by the Company of \$150.0 million principal amount of the Company's senior subordinated notes and 3.5 million shares of the Company's Class B Common Stock, the sale of 1,000 shares of the Company's Series B Preferred Stock (\$10.0 million) and warrants to Bull Run and the sale of KTVE Inc., the Company's broadcast station in Monroe, Louisiana/El Dorado, Arkansas. Additionally, the Company plans to retire its existing bank credit facility and other senior indebtedness (See Notes E and F) and enter into a new bank credit facility.

In connection with the Phipps Acquisition, a bank has provided a \$10.0 million stand-by letter of credit to the seller of the Phipps Business on behalf of the Company. The letter of credit will be payable under certain conditions if the Phipps Acquisition is not completed. In connection with the issuance of the letter of credit, a stockholder of the Company has executed a put agreement which the bank can exercise if the Company defaults on repayment of any amounts that might be paid in accordance with the terms of the letter of credit.

NOTE C -- BUSINESS ACQUISITIONS (CONTINUED)
 1996 ACQUISITIONS

On January 4, 1996, the Company purchased substantially all of the assets of WRDW-TV, a CBS television affiliate serving the Augusta, Georgia television market (the "Augusta Acquisition"). The purchase price of approximately \$35.9 million, excluding assumed liabilities of approximately \$1.3 million, was financed primarily through long-term borrowings. The assets acquired consisted of office equipment and broadcasting operations located in North Augusta, South Carolina. Based on a preliminary allocation of the purchase price, the excess of the purchase price over the fair value of net tangible assets acquired was approximately \$32.5 million. In connection with the Augusta Acquisition, the Company's Board of Directors approved the payment of a \$360,000 finders fee to Bull Run.

Funds for the Augusta Acquisition were obtained from the modification of the Company's existing bank debt to a variable rate reducing revolving credit facility (the "Senior Credit Facility") and the sale to Bull Run of an 8% subordinated note due January 3, 2005 in the principal amount of \$10.0 million (the "8% Note"). In connection with the sale of the 8% Note, the Company also issued warrants to Bull Run to purchase 487,500 shares of Class A Common Stock at \$17.88 per share, 300,000 shares of which are currently vested, with the remainder vesting in five equal annual installments commencing in 1997 provided that the 8% Note is outstanding. The Senior Credit Facility provides for a credit line up to \$55.0 million, of which \$52.6 million was outstanding at March 31, 1996. This transaction also required a modification of the interest rate of the Company's \$25.0 million senior secured note with an institutional investor from 10.08% to 10.7%.

As part of the financing arrangements for the Phipps Acquisition, the 8% Note will be retired and the Company will issue to Bull Run, in exchange for the 8% Note, 1,000 shares of Series A Preferred Stock. The warrants issued with the 8% Note will vest in accordance with the schedule described above provided the Series A Preferred Stock remains outstanding.

An unaudited pro forma statement of income for the three months ended March 31, 1995, is presented below and assumes that the Augusta Acquisition occurred on January 1, 1995.

This pro forma unaudited statement of income does not purport to represent the Company's actual results of operations had the Augusta Acquisition occurred on January 1, 1995, and should not serve as a forecast of the Company's operating results for any future periods. The pro forma adjustments are based solely upon certain assumptions that management believes are reasonable under the circumstances at this time. Subsequent adjustments are expected upon final determination of the allocation of the purchase price. An unaudited pro forma statement of income for the three months ended March 31, 1995 is as follows (in thousands, except per share data):

Operating revenues.....	\$ 15,106
Operating expenses.....	12,906

	2,200
Miscellaneous income (expense), net.....	45
Interest expense.....	2,269

Pro forma loss before income taxes.....	(24)
Income tax benefit.....	(8)

Pro forma net loss.....	\$ (16)

Pro forma average shares outstanding.....	4,221

Pro forma earnings per share.....	\$.00

NOTE C -- BUSINESS ACQUISITIONS (CONTINUED)
1995 ACQUISITION

On January 6, 1995, the Company purchased substantially all of the assets of the GWINNETT POST-TRIBUNE and assumed certain liabilities (the "Gwinnett Acquisition"). The assets consist of office equipment and publishing operations located in Lawrenceville, Georgia. The purchase price of \$3.7 million, including assumed liabilities of approximately \$370,000, was paid by approximately \$1.2 million in cash (financed through long-term borrowings and cash from operations), the issuance of 44,117 shares of Class A Common Stock (having fair value of \$500,000), and \$1.5 million payable to the sellers pursuant to non-compete agreements. The excess of the purchase price over the fair value of net tangible assets acquired was approximately \$3.4 million. In connection with the Gwinnett Acquisition the Company's Board of Directors approved the payment of a \$75,000 finders fee to Bull Run.

NOTE D -- STOCKHOLDERS' EQUITY

A portion of the funds for the Augusta Acquisition was obtained from the 8% Note, which included the issuance of detachable warrants to Bull Run to purchase 487,500 shares of Class A Common Stock at \$17.88 per share, 300,000 shares of which are currently vested, with the remainder vesting in five equal annual installments commencing in 1997 provided that the 8% Note is outstanding. Approximately \$2.6 million of the \$10.0 million of proceeds from the 8% Note was allocated to the warrants and increased Class A Common Stock. This allocation of the proceeds was based on an estimate of the relative fair values of the 8% Note and the warrants on the date of issuance. The Company is amortizing the original issue discount over the period of time that the 8% Note is to be outstanding. During the three months ended March 31, 1996, the Company recognized approximately \$72,000 in amortization costs for the \$2.6 million original issue discount.

NOTE E -- COMMITMENTS AND CONTINGENCIES

The Company entered into an interest rate swap agreement on June 2, 1995, to effectively convert a portion of its floating rate debt to a fixed rate basis. The interest rate swap is effective for five years. Approximately \$25.0 million of the Company's outstanding long-term debt was subject to this interest rate swap agreement at March 31, 1996. The effective rate of the Senior Credit Facility and interest rate swap at March 31, 1996, was approximately 8.96% and 9.61%, respectively. The unrealized gain for the interest rate swap was approximately \$109,000 at March 31, 1996, based upon comparison to treasury bond yields for bonds with similar maturity dates as the interest rate swap.

On May 15, 1996 the Company entered into an agreement with GOCOM Television of Ouachita, L.P., to sell the assets of KTVE Inc., the Company's NBC-affiliated station serving Monroe, Louisiana/ El Dorado, Arkansas, for approximately \$9.5 million in cash plus the amount of the accounts receivable on the date of closing (estimated to be approximately \$750,000) to the extent collected by the buyer, to be paid to the Company 150 days following the date of closing. The sale agreement regarding KTVE included a number of closing conditions. The Company completed the sale of the assets of KTVE Inc. on August 20, 1996. The Company anticipates recognizing in the quarter ended September 30, 1996, the gain net of income taxes, and the estimated income taxes on the sale of KTVE of approximately \$2.8 million and \$2.8 million, respectively.

NOTE E -- COMMITMENTS AND CONTINGENCIES (CONTINUED)

A condensed balance sheet of KTVE is as follows (in thousands):

		MARCH 31, 1996
Current assets.....	\$	893
Property and equipment.....		1,647
Other assets.....		557
Total assets.....	\$	3,097
Current liabilities.....	\$	298
Other liabilities.....		476
Stockholders' equity.....		2,323
Total liabilities and stockholders' equity.....	\$	3,097

Condensed statement of operations data of KTVE is as follows (in thousands):

	THREE MONTHS ENDED MARCH 31,	
	1995	1996
Broadcasting revenues.....	\$ 919	\$ 1,066
Expenses.....	931	970
Operating income (loss).....	(12)	96
Other income.....	4	3
Income (loss) before income taxes.....	(8)	99
Net income (loss).....	\$ (5)	\$ 59

NOTE F -- SUBSEQUENT EVENTS

On May 2, 1996, the Company filed a Registration Statement with the Securities and Exchange Commission (the "SEC") on Form S-1 to register the sale of 4,025,000 shares of Class B Common Stock, including an over-allotment option granted by the Company to the underwriters of such offering, subject to shareholder approval. Also on May 2, 1996 the Company filed a Registration Statement with the SEC on Form S-1 to register the sale of \$150,000,000 Senior Subordinated Notes due 2006. On May 13, July 9, and August 9, 1996, the Company filed amendments to such Registration Statements.

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

RESULTS OF OPERATIONS OF THE COMPANY

INTRODUCTION

The Company derives its revenues from its television broadcasting and publishing operations. As a result of the Augusta Acquisition and the acquisition of WKYT-TV and WYMT-TV in September 1994, the proportion of the Company's revenues derived from television broadcasting has increased and will continue to increase as a result of the Phipps Acquisition, which is expected to occur by September 1996. As a result of the higher operating margins associated with the Company's television broadcasting operations, the profit contribution of these operations as a percentage of revenues has exceeded, and is expected to continue to exceed, the profit contribution of the Company's publishing operations. Set forth below, for the periods indicated, is certain information concerning the relative contributions of the Company's television broadcasting and publishing operations.

	THREE MONTHS ENDED MARCH 31,			
	1995		1996	
	AMOUNT	PERCENT OF TOTAL	AMOUNT	PERCENT OF TOTAL
	(DOLLARS IN THOUSANDS)			
TELEVISION BROADCASTING				
Revenues.....	\$ 8,349.7	63.5%	\$ 11,449.6	67.2%
Operating income (1).....	2,067.4	77.4	3,127.4	88.6
PUBLISHING				
Revenues.....	\$ 4,800.6	36.5%	\$ 5,576.9	32.8%
Operating income (1).....	603.9	22.6	401.3	11.4

(1) Excludes any allocation of corporate and administrative expenses.

TELEVISION BROADCASTING

Set forth below are the principal types of broadcasting revenues earned by the Company's television stations for the periods indicated and the percentage contribution of each to total Company revenues:

	THREE MONTHS ENDED MARCH 31,			
	1995		1996	
	AMOUNT	PERCENT OF TOTAL COMPANY REVENUES	AMOUNT	PERCENT OF TOTAL COMPANY REVENUES
	(DOLLARS IN THOUSANDS)			
NET REVENUES:				
Local.....	\$ 4,964.4	37.7%	\$ 6,675.4	39.2%
National.....	2,470.0	18.9	3,089.3	18.1
Network compensation.....	595.7	4.5	866.6	5.1
Political.....	25.4	0.2	212.9	1.2
Production and other.....	294.2	2.2	605.4	3.6
	\$ 8,349.7	63.5%	\$ 11,449.6	67.2%

In the Company's broadcasting operations, broadcast advertising is sold for placement either preceding or following a television station's network programming and within local and syndicated programming. Broadcast advertising is sold in time increments and is priced primarily on the basis of a program's popularity among the specific audience an advertiser desires to reach, as measured by Nielsen. In addition, broadcast advertising rates are affected by the number of advertisers competing for the available time, the size and demographic makeup of the market served by the station and the availability of alternative advertising media in the market area. Broadcast advertising rates are the

highest during the most desirable viewing hours, with corresponding reductions during other hours. The ratings of a local station affiliated with a major network can be affected by ratings of network programming.

Most broadcast advertising contracts are short-term, and generally run only for a few weeks. The Company estimates that approximately 57.6% of the gross revenues of the Company's television stations for the three months ended March 31, 1996 were generated from local advertising which is sold by a station's sales staff directly to local accounts, and the remainder represents national advertising, which is sold by a station's national advertising representative. The stations generally pay commissions to advertising agencies on local, regional and national advertising and the stations also pay commissions to the national sales representative on national advertising.

Broadcast advertising revenues are generally highest in the second and fourth quarters of each year, due in part to increases in retail advertising in the spring and in the period leading up to and including the holiday season. In addition, broadcast advertising revenues are generally higher during even numbered election years due to spending by political candidates, which spending typically is heaviest during the fourth quarter.

The broadcasting operations' primary operating expenses are employee compensation, related benefits and programming costs. In addition, the broadcasting operations incur overhead expenses such as maintenance, supplies, insurance, rent and utilities. A large portion of the operating expenses of the broadcasting operations is fixed.

PUBLISHING

Set forth below are the principal types of publishing revenues earned by the Company's publishing operations for the periods indicated and the percentage contribution of each to total Company revenues:

	THREE MONTHS ENDED MARCH 31,			
	1995		1996	
	AMOUNT	PERCENT OF TOTAL COMPANY REVENUES	AMOUNT	PERCENT OF TOTAL COMPANY REVENUES
(DOLLARS IN THOUSANDS)				
NET REVENUES:				
Retail advertising.....	\$ 2,443.7	18.6%	\$ 2,607.6	15.3%
Classified.....	1,175.4	8.9	1,482.2	8.7
Circulation.....	928.3	7.1	1,114.9	6.6
Other.....	253.2	1.9	372.2	2.2
	-----	---	-----	---
	\$ 4,800.6	36.5%	\$ 5,576.9	32.8%
	-----	---	-----	---
	-----	---	-----	---

In the Company's publishing operations, advertising contracts are generally annual and primarily provide for a commitment as to the volume of advertising purchased by a customer. The publishing operations' advertising revenues are primarily generated from retail advertising. As with the broadcasting operations, the publishing operations' revenues are generally highest in the second and fourth quarters of each year.

The publishing operations' primary operating expenses are employee compensation, related benefits and newsprint costs. In addition, the publishing operations incur overhead expenses such as maintenance, supplies, insurance, rent and utilities. A large portion of the operating expenses of the publishing operations is fixed, although the Company has experienced significant variability in its newsprint costs in recent years.

MEDIA CASH FLOW

The following table sets forth certain operating data for both the broadcast and publishing operations for the three months ended March 31, 1995 and 1996:

	THREE MONTHS ENDED MARCH 31,	
	1995	1996
	(DOLLARS IN THOUSANDS)	
Operating income.....	\$ 1,991.1	\$ 2,677.8
Add:		
Amortization of program license rights.....	401.8	646.8
Depreciation and amortization.....	878.7	1,395.3
Corporate overhead.....	493.0	775.6
Non-cash compensation and contributions to the Company's 401(k) plan, paid in Class A Common Stock.....	301.4	131.5
Less:		
Payments for program license liabilities.....	(481.3)	(661.6)
Media Cash Flow (1).....	\$ 3,584.7	\$ 4,965.4

(1) Of Media Cash Flow, \$2.7 million and \$4.2 million was attributable to the Company's broadcasting operations during the three months ended March 31, 1995 and 1996, respectively.

"Media Cash Flow" is defined as operating income from broadcast and publishing operations before income taxes and interest expense, plus depreciation and amortization (including amortization of program license rights), non-cash compensation and corporate overhead, less payments for program license liabilities. The Company has included Media Cash Flow data because such data are commonly used as a measure of performance for broadcast companies and are also used by investors to measure a company's ability to service debt. Media Cash Flow is not, and should not be used as, an indicator or alternative to operating income, net income or cash flow as reflected in the consolidated financial statements of the Company and is not a measure of financial performance under generally accepted accounting principles and should not be considered in isolation or as a substitute for measures of performance prepared in accordance with generally accepted accounting principles.

THREE MONTHS ENDED MARCH 31, 1996 COMPARED TO THREE MONTHS ENDED MARCH 31, 1995

REVENUES. Total revenues for the three months ended March 31, 1996 increased \$3.9 million, or 29.5%, over the three months ended March 31, 1995, from \$13.1 million to \$17.0 million. This increase was attributable to (i) the Augusta Acquisition, which occurred on January 4, 1996 and (ii) increases in publishing and broadcasting (excluding the Augusta Acquisition) revenues. The Augusta Acquisition accounted for \$2.1 million, or 53.6%, of the revenue increase.

Broadcast net revenues increased \$3.1 million, or 37.1%, over the same period of the prior year, from \$8.3 million to \$11.4 million. Revenues generated by the Augusta Acquisition accounted for \$2.1 million, or 67.1%, of the increase. On a pro forma basis, broadcast net revenues for WRDW for the three months ended March 31, 1996 increased \$125,000, or 6.4%, over the same period of the prior year. Broadcast net revenues, excluding the Augusta Acquisition, increased \$1.0 million, or 12.2%, over the three months ended March 31, 1995. Approximately \$627,000 and \$117,000 of the \$1.0 million increase in total broadcast net revenues, excluding the Augusta Acquisition, were due to higher local and political advertising spending, respectively. The Company's broadcast operations also experienced increased revenues of approximately \$200,000 associated with a sports programming joint venture which covered the University of Kentucky's NCAA basketball championship.

Publishing revenues increased \$776,000, or 16.2%, over the three months ended March 31, 1995, from \$4.8 million to \$5.6 million. Advertising and circulation revenues comprised \$471,000 and \$187,000, respectively, of the revenue increase. The increase in advertising revenue was primarily the

result of rate and lineage increases in classified advertising. The increase in circulation revenue can be attributed primarily to price increases over the same period of the prior year and the conversion of the GWINNETT DAILY POST to a five-day-a-week paper. Approximately \$95,000 of the publishing revenue increase was the result of higher special events revenue.

OPERATING EXPENSES. Operating expenses for the three months ended March 31, 1996 increased \$3.2 million, or 28.6%, over the three months ended March 31, 1995, from \$11.2 million to \$14.4 million, due to the Augusta Acquisition and increased expenses at the broadcasting and publishing operations.

Broadcasting expenses for the three months ended March 31, 1996 increased \$1.7 million, or 30.8%, over the same period of the prior year, from \$5.6 million to \$7.3 million. This increase was primarily attributable to the Augusta Acquisition. On a pro forma basis, broadcast expenses for the Augusta Acquisition for the three months ended March 31, 1996 decreased \$133,000, or 9.1%, over the same period of 1995, from \$1.4 million to \$1.3 million. Broadcasting expenses, excluding the Augusta Acquisition, increased \$391,000, or 7.0%, primarily as a result of higher payroll related costs.

Publishing expenses for the three months ended March 31, 1996 increased \$846,000, or 21.4%, over the same period of the prior year, from \$4.0 million to \$4.8 million. This increase resulted primarily from the conversion of the GWINNETT DAILY POST to a five-day-a-week paper and the acquisition of shoppers in September 1995. Newsprint costs increased 27% while consumption of newsprint increased 11%. Payroll related costs, promotional costs, product delivery costs and outside service costs increased over the same quarter of the prior year.

Corporate and administrative expenses for the three months ended March 31, 1996 increased \$283,000, or 57.3%, over the same period of the prior year, from \$493,000 to \$776,000. This increase was attributable primarily to the addition of several new officers.

Depreciation of property and equipment and amortization of intangible assets was \$1.4 million for the three months ended March 31, 1996 compared to \$879,000 for the same period of the prior year, an increase of \$516,000, or 58.8%. This increase was primarily the result of higher depreciation and amortization costs related to the Augusta Acquisition and \$3.3 million of capital expenditures made in 1995.

Non-cash compensation paid in Class A Common Stock resulting from the Company's employment agreements with its current President and its former chief executive officer decreased \$176,000, or 74.6%, for the three months ended March 31, 1996, from \$236,000 to \$60,000. This decrease resulted from the Company's award in 1995 of 150,000 shares of Class A Common Stock to its former chief executive officer, the expense for such award was recognized in 1995 (including \$176,000 recognized in the quarter ended March 31, 1995).

INTEREST EXPENSE. Interest expense increased \$853,000, or 61.9%, from \$1.4 million for the three months ended March 31, 1995 to \$2.2 million for the three months ended March 31, 1996. This increase was attributable primarily to increased levels of debt resulting from the financing of the Augusta Acquisition.

NET INCOME. Net income for the Company was \$311,000 for the three months ended March 31, 1996, compared with \$404,000 for the same period in 1995, a decrease of \$93,000.

LIQUIDITY AND CAPITAL RESOURCES

The Company's working capital (deficiency) was \$(221,000) and \$3.1 million at December 31, 1995 and March 31, 1996, respectively. The Company's cash provided from operations was \$1.5 million and \$3.1 million for the three months ended March 31, 1995 and 1996, respectively.

The Company's cash used in investing activities was \$2.4 million and \$36.0 million for the three months ended March 31, 1995 and 1996, respectively. The increased usage of \$33.6 million was due primarily to the Augusta Acquisition.

The Company was provided \$582,000 and \$34.4 million in cash by financing activities for the three months ended March 31, 1995 and 1996, respectively, due primarily to the funding of the Gwinnett Acquisition in 1995 and the Augusta Acquisition in 1996. Long-term debt was \$85.9 million and the balance of the Senior Credit Facility was \$52.6 million, at March 31, 1996. The effective interest rate of the Senior Credit Facility was 8.96% on March 31, 1996. Principal maturities of long-term debt were \$1.5 million at March 31, 1996. The Company anticipates that its operating cash flows, together with borrowings available under the Senior Credit Facility will be sufficient to provide for such payments.

In the three months ended March 31, 1996, the Company made \$814,000 in capital expenditures relating primarily to broadcasting operations. The Company anticipates making \$3.0 million in capital expenditures for the year ending December 31, 1996. The Company believes that cash flows from operations will be sufficient to fund such expenditures, which will be adequate for the Company's normal replacement requirements.

The Company regularly enters into program contracts for the right to broadcast television programs produced by others and program commitments for the right to broadcast programs in the future. Such programming commitments are generally made to replace expiring or canceled program rights. Payments under such contracts are made in cash or the concession of advertising spots for the program provider to resell, or a combination of both. During the three months ended March 31, 1996 the Company paid \$662,000 for such program broadcast rights.

On May 15, 1996, the Company entered into an agreement with GOCOM Television of Ouachita, L.P. to sell the assets of KTVE Inc. for approximately \$9.5 million in cash plus the amount of the accounts receivable on the date of the closing. The Company completed the sale of the assets of KTVE Inc. on August 20, 1996. The Company anticipates recognizing in the quarter ended September 30, 1996, the gain, net of income taxes, and the income taxes resulting from the sale of KTVE of approximately \$2.8 million and \$2.8 million, respectively.

In connection with the Phipps Acquisition, the Company will be required to divest WALB and WJHG under current FCC regulations. However, these rules may be revised by the FCC upon conclusion of pending rule-making proceedings. In order to satisfy applicable FCC requirements, the Company, subject to FCC approval, intends to swap such assets for assets of one or more television stations of comparable value and with comparable broadcast cash flow in a transaction qualifying for deferred capital gains treatment under the "like-kind exchange" provision of Section 1031 of the Code. If the Company is unable to effect such a swap on satisfactory terms within the time period granted by the FCC under the waivers, the Company may transfer such assets to a trust with a view towards the trustee effecting a swap or sale of such assets. Any such trust arrangement would be subject to the approval of the FCC. It is anticipated that the Company would be required to relinquish operating control of such assets to a trustee while retaining the economic risks and benefits of ownership. If the Company or such trust is required to effect a sale of WALB, the Company would incur a significant gain and related tax liability, the payment of which could have a material adverse effect on the Company's ability to acquire comparable assets without incurring additional indebtedness.

Following the consummation of the sale of KTVE, the Phipps Acquisition, and the public offerings, the Company will be highly leveraged. The Company anticipates that its principal uses of cash will be working capital and debt service requirements, cash dividends, capital expenditures and expenditures related to additional acquisitions. The Company anticipates that its operating cash flow, together with borrowings available under the Senior Credit Facility, will be sufficient for such purposes.

The Company does not believe that inflation in past years has had a significant impact on the Company's results of operations nor is inflation expected to have a significant effect upon the Company's business in the near future.

PART II.
OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

11 -- Statement re: Computation of Earnings Per Share

27 -- Financial Data Schedule

(b) Reports on Form 8-K

A report on Form 8-K was filed on January 18, 1996, reporting the purchase of WRDW from Television Station Partners, L.P. and WRDW Associates.

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.

GRAY COMMUNICATIONS SYSTEMS, INC.
(Registrant)

Date: September 9, 1996

By: /s/ WILLIAM A. FIELDER, III

William A. Fielder, III, Vice President &
Chief Financial Officer
(Chief Financial Officer)

Date: September 9, 1996

By: /s/ SABRA H. COWART

Sabra H. Cowart, Controller &
Chief Accounting Officer
(Chief Accounting Officer)

STATEMENT RE: COMPUTATION OF EARNINGS PER SHARE

	THREE MONTHS ENDED MARCH 31	
	1995	1996
Primary:		
Weighted average shares outstanding.....	4,221,705	4,443,617
Common Stock Equivalents -- based on the treasury stock method using average market price.....	85,890	163,156
Totals.....	4,307,595	4,606,773
Net income.....	\$ 403,957	\$ 311,211
Per share amount.....	\$.09	\$.07
Fully diluted:		
Weighted average shares outstanding.....	4,221,705	4,443,617
Common Stock Equivalents -- based on the treasury stock method using quarter-end market price which is greater than average market price.....	127,968	193,380
Totals.....	4,349,673	4,636,997
Net income.....	\$ 403,957	\$ 311,211
Per share amount.....	\$.09	\$.07

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE MARCH 31, 1996 UNAUDITED FINANCIAL STATEMENTS OF THE COMPANY AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL INFORMATION.

3-MOS		
	DEC-31-1996	
	JAN-01-1996	
	MAR-31-1996	
		2,081,627
		0
	10,768,128	
	623,000	
	231,964	
	15,422,197	
		40,505,148
	21,406,793	
	113,544,651	
12,338,344		
		84,396,637
	0	
		0
		9,862,594
		2,411,757
113,544,651		
		0
	17,026,579	
		0
	14,348,767	
	(63,514)	
	210,941	
2,229,115		
	512,211	
	201,000	
311,211		
	0	
	0	
		0
	311,211	
	.07	
	.07	