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

Form 10-Q

(Mark one)

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

For the quarterly period ended June 30, 1999.

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	58-0285030
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

4370 Peachtree Road, NE, Atlanta, Georgia 30319
(Address of principal executive offices)
(Zip code)

(404) 504-9828
(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)	Class B Common Stock (No Par Value)
6,832,042 shares as of August 4, 1999	5,144,393 shares as of August 4, 1999

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GRAY COMMUNICATIONS SYSTEMS, INC.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GRAY COMMUNICATIONS SYSTEMS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 1999	December 31, 1998
	(Unaudited)	
CURRENT ASSETS:		
Cash and cash equivalents	$ 5,084,986	$ 1,886,723
Trade accounts receivable, less allowance for doubtful accounts of $1,239,000 and $1,212,000, respectively	22,794,918	22,859,119
Recoverable income taxes	1,586,515	1,725,535
Inventories	877,689	1,191,284
Current portion of program broadcast rights	1,206,179	3,226,359
Other current assets	1,013,609	741,007
Total current assets	32,563,896	31,630,027
PROPERTY AND EQUIPMENT:		
Land	2,456,020	2,196,021
Buildings and improvements	13,555,417	12,812,112
Equipment	70,878,159	65,226,835
	86,889,596	80,234,968
Allowance for depreciation	(34,005,075)	(28,463,460)
	52,884,521	51,771,508
OTHER ASSETS:		
Deferred loan costs	7,691,525	8,235,432
Goodwill and other intangibles:		
Licenses and network affiliation agreements	342,021,586	346,433,820
Goodwill	40,836,795	28,766,950
Consulting and noncompete agreements	2,116,783	814,202
Other	2,712,607	1,322,483
	395,379,296	385,572,887
	$480,827,713	$468,974,422

See notes to condensed consolidated financial statements.

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

	June 30, 1999 (Unaudited)	December 31, 1998
CURRENT LIABILITIES:		
Trade accounts payable (includes $0 and $880,000 payable to Bull Run Corporation, respectively)	$ 804,580	$ 2,540,770
Employee compensation and benefits	4,717,646	5,195,777
Accrued expenses	2,310,503	1,903,226
Accrued interest	5,049,157	5,608,134
Current portion of program broadcast obligations	1,027,539	3,070,598
Deferred revenue	3,247,597	2,632,564
Current portion of long-term debt	385,000	430,000
Total current liabilities	17,542,022	21,381,069
LONG-TERM DEBT	291,286,715	270,225,255
OTHER LONG-TERM LIABILITIES:		
Program broadcast obligations, less current portion	416,685	735,594
Supplemental employee benefits	1,052,384	1,128,204
Deferred income taxes	43,119,641	44,147,642
Other acquisition related liabilities	4,227,595	4,653,788
	48,816,305	50,665,228
Commitments and contingencies		
STOCKHOLDERS' EQUITY:		
Serial Preferred Stock, no par value; authorized 20,000,000 shares; issued and outstanding 1,350 shares, respectively ($13,500,000 aggregate liquidation value, respectively)	13,500,000	13,500,000
Class A Common Stock, no par value; authorized 15,000,000 shares; issued 7,961,574 shares, respectively	10,683,709	10,683,709
Class B Common Stock, no par value; authorized 15,000,000 shares; issued 5,273,046 shares, respectively	66,866,468	66,792,385
Retained earnings	42,112,478	45,737,601
	133,162,655	136,713,695
Treasury Stock at cost, Class A Common Stock, 1,129,532 shares, respectively	(8,578,682)	(8,578,682)
Treasury Stock at cost, Class B Common Stock, 128,653 and 135,080 shares, respectively	(1,401,302)	(1,432,143)
	123,182,671	126,702,870
	$480,827,713	$468,974,422

See notes to condensed consolidated financial statements.

GRAY COMMUNICATIONS SYSTEMS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	1999	1998	1999	1998
OPERATING REVENUES				
Broadcasting (net of agency commissions)	$23,137,952	$22,689,990	$44,305,992	$42,201,054
Publishing	9,535,608	7,379,114	17,557,661	13,916,449
Paging	2,355,609	1,991,407	4,557,586	3,924,873
	35,029,169	32,060,511	66,421,239	60,042,376
EXPENSES				
Broadcasting	13,684,523	12,661,021	26,673,047	24,779,408
Publishing	7,355,448	5,983,435	13,710,070	11,440,940
Paging	1,724,483	1,327,495	3,238,128	2,583,100
Corporate and administrative	940,644	656,449	1,687,150	1,316,929
Depreciation and amortization	5,663,547	4,221,723	11,119,364	7,843,307
	29,368,645	24,850,123	56,427,759	47,963,684
	5,660,524	7,210,388	9,993,480	12,078,692
Miscellaneous income (expense), net	34,613	(73,209)	456,361	(314,276)
	5,695,137	7,137,179	10,449,841	11,764,416
Interest expense	7,004,508	6,039,258	13,774,671	11,966,739
INCOME (LOSS) BEFORE INCOME TAXES	(1,309,371)	1,097,921	(3,324,830)	(202,323)
Income tax expense (benefit)	(229,000)	260,814	(684,000)	443,377
NET INCOME(LOSS)	(1,080,371)	837,107	(2,640,830)	(645,700)
Preferred Dividends	252,501	358,998	505,002	717,996
NET INCOME (LOSS) AVAILABLE TO COMMON STOCKHOLDERS	$(1,332,872)	$ 478,109	$(3,145,832)	$(1,363,696)
AVERAGE OUTSTANDING COMMON SHARES:				
Basic	11,966,489	11,916,754	11,960,572	11,898,798
Stock compensation awards	-0-	599,413	-0-	-0-
Diluted	11,966,489	12,516,167	11,960,572	11,898,798
BASIC EARNINGS (LOSS) PER COMMON SHARE:				
Net income (loss) available to common stockholders	$ (0.11)	$ 0.04	$ (0.26)	$(0.11)
DILUTED EARNINGS (LOSS) PER COMMON SHARE:				
Net income (loss) available to common stockholders	$ (0.11)	$ 0.04	$ (0.26)	$(0.11)

See notes to condensed consolidated financial statements.

GRAY COMMUNICATIONS SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (Unaudited)

	Preferred Stock		Class A Common Stock		Class B Common Stock		Retained Earnings
	Shares	Amount	Shares	Amount	Shares	Amount	
Balance at December 31, 1998	1,350	$ 13,500,000	7,961,574	$ 10,683,709	5,273,046	$ 66,792,385	$ 45,737,601
Net loss for the six months ended June 30, 1999							(2,640,830)
Common stock dividends ($.04 per share)							(479,291)
Preferred stock dividends							(505,002)
Issuance of treasury stock: 401 (k) plan						74,083	
Purchase of Class B Common Stock							
Balance at June 30, 1999	1,350	$ 13,500,000	7,961,574	$ 10,683,709	5,273,046	$ 66,866,468	$ 42,112,478

	Class A Treasury Stock		Class B Treasury Stock		
	Shares	Amount	Shares	Amount	Total
Balance at December 31, 1998	(1,129,532)	$ (8,578,682)	(135,080)	$(1,432,143)	$126,702,870
Net loss for the six months ended June 30, 1999					(2,640,830)
Common stock dividends ($.04 per share)					(479,291)
Preferred stock dividends					(505,002)
Issuance of treasury stock: 401 (k) plan			26,427	287,845	361,928
Purchase of Class B Common Stock			(20,000)	(257,004)	(257,004)
Balance at June 30, 1999	(1,129,532)	$ (8,578,682)	(128,653)	$(1,401,302)	$123,182,671

See notes to condensed consolidated financial statements.

GRAY COMMUNICATIONS SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	Six Months Ended June 30, 1999	Six Months Ended June 30, 1998
OPERATING ACTIVITIES		
Net loss	$(2,640,830)	$ (645,700)
Items which did not use (provide) cash:		
Depreciation	5,772,877	4,175,981
Amortization of intangible assets	5,346,487	3,667,326
Amortization of deferred loan costs	574,282	541,723
Amortization of program broadcast rights	2,400,745	1,899,189
Payments for program broadcast rights	(2,430,524)	(1,954,588)
Supplemental employee benefits	(75,820)	(154,657)
Common Stock contributed to 401(k) Plan	361,928	241,761
Deferred income taxes	(1,028,001)	68,686
(Gain) loss on disposal of assets	(331,157)	348,310
Changes in operating assets and liabilities:		
Receivables, inventories and other current assets	715,870	(1,012,774)
Accounts payable and other current liabilities	(2,199,854)	1,260,198
NET CASH PROVIDED BY OPERATING ACTIVITIES	6,466,003	8,435,455
INVESTING ACTIVITIES		
Purchase of newspaper business	(16,512,231)	-0-
Purchase of FCC license	-0-	(829,600)
Purchases of property and equipment	(4,499,224)	(5,766,160)
Deferred acquisition costs	(1,190,978)	(200,745)
Payments on purchase liabilities	(584,098)	(269,018)
Deferred costs associated with the exchange of television station	-0-	(859,534)
Proceeds from asset sales	-0-	182,421
Other	41,504	(241,707)
NET CASH USED IN INVESTING ACTIVITIES	(22,745,027)	(7,984,343)
FINANCING ACTIVITIES		
Dividends paid	(1,251,794)	(717,400)
Class A Common Stock transactions	-0-	27,564
Class B Common Stock transactions	-0-	26,326
Purchase of treasury stock	(257,004)	(311,063)
Sale of treasury stock	-0-	1,070,272
Proceeds from borrowings of long-term debt	36,200,000	10,200,000
Payments on long-term debt	(15,183,540)	(10,374,923)
Deferred loan costs	(30,375)	-0-
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	19,477,287	(79,224)
INCREASE IN CASH AND CASH EQUIVALENTS	3,198,263	371,888
Cash and cash equivalents at beginning of period	1,886,723	2,367,300
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$5,084,986	$2,739,188

See notes to condensed consolidated financial statements.

NOTE A--BASIS OF PRESENTATION

The accompanying unaudited condensed 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 with the 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 six month period ended June 30, 1999 are not necessarily indicative of the results that may be expected for the year ending December 31, 1999. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 1998.

NOTE B--BUSINESS ACQUISITIONS

On April 14, 1999, the Company announced that it had entered into agreements to acquire the CBS affiliates KWTX-TV ("KWTX") located in Waco, Texas and KBTX-TV ("KBTX"), a satellite station of KWTX located in Bryan, Texas, each serving the Waco-Temple-Bryan, Texas television market. In addition, the Company has agreed to acquire KXII-TV ("KXII"), which is the CBS affiliate serving Sherman, Texas and Ada, Oklahoma. These transactions are referred to herein as the "Texas Acquisition." Aggregate consideration for the Texas Acquisition will be approximately $139 million before payment for certain net working capital amounts and other fees and expenses. The Company will acquire the assets of KWTX and KBTX in merger transactions with the KWTX and KBTX shareholders receiving a combination of cash and the Company's Class B Common Stock for their shares. The Company will acquire KXII in an all cash transaction. The Texas Acquisition is subject to a number of conditions, including the approval by the shareholders of the Company. Approval for the Texas Transaction was granted by the Federal Communications Commission (the "FCC") during the second quarter of 1999. The Company currently believes that the Texas Transaction will close on October 1, 1999.

NOTE C--LONG-TERM DEBT

The Company's bank loan agreement (the "Senior Credit Facility") provides for $200.0 million of committed credit and $100.0 million of uncommitted credit. The Company can borrow the $100.0 million in uncommitted available credit only after approval of the bank consortium. At June 30, 1999, the balance outstanding and the balance available under the $200.0 million committed portion of the Senior Credit Facility were $130.7 million and $69.3 million, respectively, and the interest rate on the balance outstanding was 7.01%. At June 30, 1999, the bank consortium had not committed, nor had the Company borrowed, any funds under the uncommitted $100.0 million portion of the Senior Credit Facility.

NOTE D--INFORMATION ON BUSINESS SEGMENTS

The Company operates in three business segments: broadcasting, publishing and paging. The broadcasting segment operates ten television stations located in the southeastern and mid-western United States at June 30, 1999. The publishing segment operates four daily newspapers in three different markets, and an area weekly advertising only publication in Georgia. The paging operations are located in Florida, Georgia, and Alabama. The following tables present certain financial information concerning the Company's three operating segments:

NOTE D--INFORMATION ON BUSINESS SEGMENTS (Continued)

	Three Months Ended June 30,		Six Months Ended June 30,	
	1999	1998	1999	1998
	(in thousands)			
Operating revenues:				
Broadcasting	$23,138	$22,690	$44,306	$42,201
Publishing	9,536	7,379	17,558	13,916
Paging	2,355	1,991	4,557	3,925
	$35,029	$32,060	$66,421	$60,042
Operating income:				
Broadcasting	$ 4,269	$ 6,317	$ 7,389	$10,181
Publishing	1,291	701	2,323	1,486
Paging	101	192	282	412
Total operating income	5,661	7,210	9,994	12,079
Miscellaneous income and (expense), net	35	(73)	456	(314)
Interest expense	7,005	6,039	13,775	11,967
Income (loss) before income taxes	$(1,309)	$ 1,098	$(3,325)	$ (202)

Operating income is total operating revenues less operating expenses, excluding miscellaneous income and expense (net) and interest. Corporate and administrative expenses are allocated to operating income based on net segment revenues.

	Three Months Ended June 30,		Six Months Ended June 30,	
	1999	1998	1999	1998
	(in thousands)			
Media Cash Flow:				
Broadcasting	$ 9,584	$10,118	$17,881	$17,546
Publishing	2,211	1,416	3,901	2,513
Paging	637	670	1,336	1,357
	12,432	12,204	23,118	21,416
Media Cash Flow reconciliation:				
Operating income	$ 5,661	$ 7,210	$ 9,994	$12,079
Add:				
Amortization of program broadcast rights	1,198	959	2,401	1,899
Depreciation and amortization	5,664	4,221	11,119	7,843
Corporate overhead	940	658	1,687	1,317
Non-cash compensation and contributions to the Company's 401(k) plan, paid in common stock	209	115	348	233
Less:				
Payments for program broadcast obligations	(1,240)	(959)	(2,431)	(1,955)
Media Cash Flow	$12,432	$12,204	$23,118	$21,416

NOTE D--INFORMATION ON BUSINESS SEGMENTS (Continued)

"Media Cash Flow" is defined as operating income, plus depreciation and amortization (including amortization of program broadcast rights), non-cash compensation and corporate overhead, less payments for program broadcast obligations. The Company has included Media Cash Flow data because such data are commonly used as a measure of performance for media 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 Company's financial statements. Media Cash Flow 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.

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

RESULTS OF OPERATIONS

Introduction

The following analysis of the financial condition and results of operations of Gray Communications Systems, Inc. (the "Company") should be read in conjunction with the Company's unaudited Condensed Consolidated Financial Statements and notes thereto included elsewhere herein.

On March 1, 1999, the Company acquired substantially all of the assets of The Goshen News (the "Goshen Acquisition") for aggregate cash consideration of approximately $16.7 million. The Goshen News is a 17,000 circulation afternoon newspaper serving Goshen, Indiana and surrounding areas. The Company financed the acquisition through borrowings under its bank loan agreement (the "Senior Credit Facility").

On July 31, 1998, the Company completed the purchase of all of the outstanding capital stock of Busse Broadcasting Corporation ("Busse"). The purchase price was $126.6 million, less the accreted value of Busse's 11 5/8 % Senior Secured Notes due 2000. The purchase price of the capital stock consisted of the contractual purchase price of $112.0 million, associated transaction costs of $3.9 million, acquisition costs associated with Busse's 11 5/8 % Senior Secured Notes due 2000 of $5.1 million, and Busse's cash and cash equivalents of $5.6 million. Immediately prior to the Company's acquisition of Busse, Cosmos Broadcasting Corporation acquired the assets of WEAU-TV ("WEAU") from Busse and exchanged them for the assets of WALB-TV, Inc. ("WALB"), the Company's NBC affiliate in Albany, Georgia. In exchange for the assets of WALB, the Company received the assets of WEAU, which were valued at $66.0 million, and approximately $12.0 million in cash for a total value of $78.0 million. The Company recognized a pre-tax gain of approximately $70.6 million and estimated deferred income taxes of approximately $27.5 million in connection with the exchange of WALB. As a result of these transactions, the Company added the following television stations to its existing broadcasting group: KOLN-TV("KOLN"), the CBS affiliate serving the Lincoln-Hastings-Kearney, Nebraska market; its satellite station KGIN-TV ("KGIN"), the CBS affiliate serving Grand Island, Nebraska; and WEAU, an NBC affiliate serving the La Crosse-Eau Claire, Wisconsin market. These transactions also satisfied the Federal Communications Commission's (the "FCC") requirement for the Company to divest itself of WALB.

The Company recognizes revenue from three sources: broadcasting, publishing and paging. Broadcasting revenue is generated primarily from the sale of television advertising time. Publishing revenue is generated primarily from circulation revenue and advertising revenue. Paging revenue is generated primarily from the sale of pagers and paging services. Advertising revenue is billed to the customer and recognized when the advertisement is aired or published. The Company bills its customers in advance for newspaper subscriptions and paging services and the related revenues are recognized over the period the service is provided on the straight-line basis. Revenue from the sale of pagers is recognized at the time of sale.

Broadcast advertising revenues are generally highest in the second and fourth quarters each year, due in part to increases in consumer advertising in the spring and retail advertising 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 and other political advocacy groups, which spending typically is heaviest during the fourth quarter.

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

Broadcasting, Publishing and Paging Revenues

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

	Three Months Ended June 30,			
	1999		1998	
	Amount	Percent of Total	Amount	Percent of Total
	(dollars in thousands)			
Broadcasting				
Net revenues:				
Local	$ 13,378	38.2%	$ 11,167	34.8%
National	6,917	19.8	6,530	20.4
Network compensation	1,442	4.1	1,358	4.2
Political	140	0.4	1,992	6.2
Production and other	1,261	3.6	1,643	5.2
	$ 23,138	66.1%	$22,690	70.8%
Publishing				
Net revenues:				
Retail	$ 4,302	12.3%	$ 3,447	10.8%
Classified	3,189	9.0	2,413	7.5
Circulation	1,736	5.0	1,340	4.2
Other	309	0.9	179	0.5
	$ 9,536	27.2%	$ 7,379	23.0%
Paging				
Net revenues:				
Paging lease, sales and service	$ 2,355	6.7%	$ 1,991	6.2%
Total	$ 35,029	100.0%	$ 32,060	100.0%

Broadcasting, Publishing and Paging Revenues (Continued)

	Six Months Ended June 30, 1999 Amount	1999 Percent of Total	1998 Amount	1998 Percent of Total
	(dollars in thousands)			
Broadcasting				
Net revenues:				
Local	$ 25,902	39.0%	$ 22,065	36.7%
National	12,420	18.7	12,100	20.2
Network compensation	2,838	4.3	2,573	4.3
Political	189	0.3	2,185	3.6
Production and other	2,957	4.4	3,278	5.5
	$ 44,306	66.7%	$ 42,201	70.3%
Publishing				
Net revenues:				
Retail	$ 7,984	12.0%	$ 6,424	10.7%
Classified	5,743	8.6	4,498	7.5
Circulation	3,238	4.9	2,619	4.4
Other	593	0.9	375	0.6
	$ 17,558	26.4%	$ 13,916	23.2%
Paging				
Net revenues:				
Paging lease, sales and service	$ 4,557	6.9%	3,925	6.5%
Total	$ 66,421	100.0%	$ 60,042	100.0%

Three Months Ended June 30, 1999 compared to Three Months Ended June 30, 1998

REVENUES. Total revenues for the three months ended June 30, 1999 increased $3.0 million, or 9.3%, over the same period of the prior year, to $35.0 million from $32.1 million. This increase was primarily attributable to (i) revenues resulting from the acquisition of KOLN, KGIN and WEAU (the "Busse Stations") which were purchased on July 31, 1998, (ii) increased publishing revenues and (iii) increased paging revenues, offset in part by a decrease in revenues due to the disposition on July 31, 1998 of WALB.

Broadcasting revenues increased $448,000, or 2.0%, over the same period of the prior year, to $23.1 million from $22.7 million. The acquisition of the Busse Stations accounted for an increase of $5.0 million. This increase was partially offset by a decrease in revenues of $3.2 million resulting from the sale of WALB and by a decrease in political advertising revenue of $1.5 million. On a pro forma basis, assuming the acquisition of the Busse Stations had been effective on January 1, 1998, broadcasting revenues for the Busse Stations for the three months ended June 30, 1999 decreased $446,000, or 8.1%, to $5.0 million from $5.5 million, when compared to the same period of the prior year. The $446,000 decrease in revenue of the Busse Stations was primarily attributable to a decrease in political revenue of $381,000. Broadcasting revenues, excluding the results of the Busse Stations and WALB, decreased $1.4 million, or 7.0%, over the same period of the prior year, to $18.1 million from $19.5 million. This decrease was due primarily to decreased political advertising revenue of $1.5 million.

Publishing revenues increased $2.1 million, or 29.2%, over the same period of the prior year, to $9.5 million from $7.4 million. The increase in publishing revenues was due primarily to increased revenues from the

Three Months Ended June 30, 1999 compared to Three Months Ended June 30, 1998 (Continued)

Company's existing publishing operations and from the revenues provided by The Goshen News which was acquired on March 1, 1999. Revenues from the Company's existing publishing operations increased $718,000, or 9.7%, over the same period of the prior year, to $8.1 million from $7.4 million. The primary components of the $718,000 increase in revenues from existing operations were increases in retail advertising and classified advertising revenues of $232,000 and $379,000, respectively. The Goshen News had revenues of $1.4 million for the three months ended June 30, 1999.

Paging revenues increased $364,000, or 18.3%, over the same period of the prior year, to $2.3 million from $2.0 million. The increase was attributable primarily to an increase in the number of pagers in service. The Company had approximately 87,000 pagers and 78,500 pagers in service at June 30, 1999 and 1998, respectively.

OPERATING EXPENSES. Operating expenses for the three months ended June 30, 1999 increased $4.5 million, or 18.2%, over the same period of the prior year, to $29.4 million from $24.9 million, due primarily to increased broadcasting expenses, publishing expenses, paging expenses, depreciation expense, and amortization expense.

Broadcasting expenses increased $1.0 million, or 8.0%, over the three months ended June 30, 1999, to $13.7 million from $12.7 million. The acquisition of the Busse Stations accounted for an increase of $2.4 million. This increase was partially offset by a decrease in expenses of $1.3 million resulting from the sale of WALB. On a pro forma basis, assuming the acquisition of the Busse Stations had been effective on January 1, 1998, broadcasting expenses for the Busse Stations for the three months ended June 30, 1999 increased $254,000, or 11.7%, to $2.4 million from $2.2 million. Broadcasting expenses, excluding the results of the Busse Stations and WALB, decreased $140,000, or 1.2 %, over the same period of the prior year, to $11.2 million from $11.3 million.

Publishing expenses for the three months ended June 30, 1999 increased $1.4 million, or 22.9%, from the same period of the prior year, to $7.4 million from $6.0 million. The increase in publishing expenses was due primarily to increased expenses from the Company's existing publishing operations and from the expenses of The Goshen News. Expenses of the Company's existing publishing operations increased $357,000, or 6.0%, over the same period of the prior year, to $6.3 million from $6.0 million. The increase in expenses of the Company's existing publishing operations was due primarily to payroll and transportation costs associated with increased circulation at one of the Company's daily newspapers. The Goshen News recorded expenses of $1.0 million for the three months ended June 30, 1999.

Paging expenses increased $397,000, or 30.1%, over the same period of the prior year, to $1.7 million from $1.3 million. The increase was attributable primarily to an increase in costs associated with expansion of the Company's coverage area.

Corporate and administrative expenses increased $284,000, or 43.3%, to $940,000 for the three months ended June 30, 1999 from $656,000 for the three months ended June 30, 1998. The increase was due primarily to increased payroll expense and other operating expenses.

Depreciation of property and equipment and amortization of intangible assets was $5.7 million for the three months ended June 30, 1999, as compared to $4.2 million for the same period of the prior year, an increase of $1.5 million, or 34.2%. This increase was primarily the result of higher depreciation and amortization costs related to the acquisition of the Busse Stations and The Goshen News.

MISCELLANEOUS INCOME (EXPENSE). Miscellaneous income for the three months ended June 30, 1999 was $34,000 and miscellaneous expense for the three months ended June 30, 1998 was $73,000. The change in miscellaneous income (expense) of $107,000 was due primarily to lower losses on disposal of property in the current year as compared to that of the prior year.

INTEREST EXPENSE. Interest expense increased $1.0 million, or 16.0%, to $7.0 million for the three months ended June 30, 1999 from $6.0 million for the three months ended June 30, 1998. This increase was attributable primarily

Three Months Ended June 30, 1999 compared to Three Months Ended June 30, 1998 (Continued)

to increased levels of debt resulting from the financing of the acquisitions of the Busse Stations and The Goshen News.

INCOME TAX EXPENSE (BENEFIT). Income tax benefit for the three months ended June 30, 1999 was $229,000 and income tax expense for the three months ended June 30, 1998 was $260,000. The decrease in income tax expense of $489,000 was due primarily to the recognition of a net loss before tax in the current year as compared to net income before tax recognized in the prior year.

NET INCOME (LOSS) AVAILABLE TO COMMON STOCKHOLDERS. Net loss available to common stockholders of the Company was $1.3 million for the three months ended June 30, 1999 as compared to net income available to common stockholders of the Company of $479,000 for the three months ended June 30, 1998, a decrease of $1.8 million.

Six Months Ended June 30, 1999 compared to Six Months Ended June 30, 1998

REVENUES. Total revenues for the six months ended June 30, 1999 increased $6.4 million, or 10.6%, over the same period of the prior year, to $66.4 million from $60.0 million. This increase was primarily attributable to (i) revenues resulting from the acquisition of the Busse Stations which were purchased on July 31, 1998, (ii) increased publishing revenues and (iii) increased paging revenues, offset in part by a decrease in revenues due to the disposition on July 31, 1998 of WALB.

Broadcasting revenues increased $2.1 million, or 5.0%, over the same period of the prior year, to $44.3 million from $42.2 million. The acquisition of the Busse Stations accounted for an increase of $9.6 million. This increase was partially offset by a decrease in revenues of $5.7 million resulting from the sale of WALB and by a decrease in political advertising revenue. On a pro forma basis, assuming the acquisition of the Busse Stations had been effective on January 1, 1998, broadcasting revenues for the Busse Stations for the six months ended June 30, 1999 decreased $637,000, or 6.2%, when compared to the same period of the prior year to $9.6 million from $10.2 million. The $637,000 decrease in revenue of the Busse Stations was primarily attributable to a decrease in political revenue of $501,000. Broadcasting revenues, excluding the results of the Busse Stations and WALB, decreased $1.8 million, or 5.0%, over the same period of the prior year, to $34.7 million from $36.5 million. This decrease was due primarily to decreased political advertising revenue of $1.7 million.

Publishing revenues increased $3.6 million, or 26.2%, over the same period of the prior year, to $17.6 million from $13.9 million. The increase in publishing revenues was due primarily to increased revenues from the Company's existing publishing operations and from the revenues provided by The Goshen News which was acquired on March 1, 1999. Revenues from the Company's existing publishing operations increased $1.7 million, or 12.0%, over the same period of the prior year, to $15.6 million from $13.9 million. The primary components of the $1.7 million increase in revenues from existing operations were increases in retail advertising, classified advertising and circulation revenue of $698,000, $731,000 and $199,000, respectively. The Goshen News had revenues of $2.0 million from the date of its purchase through June 30, 1999.

Paging revenues increased $632,000, or 16.1%, over the same period of the prior year, to $4.6 million from $3.9 million. The increase was attributable primarily to an increase in the number of pagers in service. The Company had approximately 87,000 pagers and 78,500 pagers in service at June 30, 1999 and 1998, respectively.

OPERATING EXPENSES. Operating expenses for the six months ended June 30, 1999 increased $8.5 million, or 17.6%, over the same period of the prior year, to $56.4 million from $48.0 million, due primarily to increased broadcasting expenses, publishing expenses, paging expenses, depreciation expense and amortization expense.

Broadcasting expenses increased $1.9 million, or 7.6%, over the six months ended June 30, 1999, to $26.7 million from $24.8 million. The acquisition of the Busse Stations accounted for an increase of $4.7 million. This

SIX MONTHS ENDED JUNE 30, 1999 COMPARED TO SIX MONTHS ENDED JUNE 30, 1998 (CONTINUED)

increase was partially offset by a decrease in expenses of $2.4 million resulting from the sale of WALB. On a pro forma basis, assuming the acquisition of the Busse Stations had been effective on January 1, 1998, broadcasting expenses of $4.7 million for the Busse Stations for the six months ended June 30, 1999 were slightly higher than the $4.4 million experienced in the prior year. Broadcasting expenses, excluding the results of the Busse Stations and WALB, decreased $431,000, or 1.9%, to $22.0 million from $22.4 million. This decrease was due primarily to decreases in payroll and other expenses of $307,000 and $386,000, respectively, partially offset by an increase in syndicated film costs of $213,000.

Publishing expenses for the six months ended June 30, 1999 increased $2.3 million, or 19.8%, from the same period of the prior year, to $13.7 million from $11.4 million. The increase in publishing expenses was due primarily to increased expenses from the Company's existing publishing operations and from the expenses of The Goshen News. Expenses of the Company's existing publishing operations increased $908,000, or 7.9%, over the same period of the prior year, to $12.3 million from $11.4 million. The increase in expenses of the Company's existing publishing operations was due primarily to payroll and transportation costs associated with increased circulation at one of the Company's daily newspapers. The Goshen News recorded expenses of $1.4 million for the six months ended June 30, 1999.

Paging expenses increased $655,000, or 25.5%, over the same period of the prior year, to $3.2 million from $2.6 million. The increase was attributable primarily to an increase in the number of pagers in service.

Corporate and administrative expenses increased $370,000, or 28.4%, to $1.7 million for the six months ended June 30, 1999 from $1.3 million for the six months ended June 30, 1998. The increase was due primarily to increased payroll expense and other operating expenses.

Depreciation of property and equipment and amortization of intangible assets was $11.1 million for the six months ended June 30, 1999, as compared to $7.8 million for the same period of the prior year, an increase of $3.3 million, or 41.8%. This increase was primarily the result of higher depreciation and amortization costs related to the acquisition of the Busse Stations and The Goshen News.

MISCELLANEOUS INCOME (EXPENSE). Miscellaneous income for the six months ended June 30, 1999 was $456,000 and miscellaneous expense for the six months ended June 30, 1998 was $314,000. The change in miscellaneous income (expense) of $770,000 was due primarily to the gain of $450,000 recognized upon the sale of one of the Company's weekly advertising publications in February 1999.

INTEREST EXPENSE. Interest expense increased $1.8 million, or 15.1%, to $13.8 million for the six months ended June 30, 1999 from $12.0 million for the six months ended June 30, 1998. This increase was attributable primarily to increased levels of debt resulting from the financing of the acquisitions of the Busse Stations and The Goshen News.

INCOME TAX EXPENSE (BENEFIT). Income tax benefit for the six months ended June 30, 1999 was $684,000 and income tax expense for the six months ended June 30, 1998 was $443,000. The decrease in income tax expense of $1.1 million was due primarily to the recognition of a net loss before tax in the current year as compared to net income before tax recognized in the prior year.

NET LOSS AVAILABLE TO COMMON STOCKHOLDERS. Net loss available to common stockholders of the Company was $3.1 million and $1.4 million for the six months ended June 30, 1999 and 1998, respectively, an increase of $1.8 million.

LIQUIDITY AND CAPITAL RESOURCES

The Company's bank loan agreement, (the "Senior Credit Facility") provides for $200.0 million of committed credit and $100.0 million of uncommitted credit. The Company can borrow the $100.0 million in uncommitted

LIQUIDITY AND CAPITAL RESOURCES (Continued)

available credit only after approval of the bank consortium. At June 30, 1999, the balance outstanding and the balance available under the $200.0 million portion of the Senior Credit Facility were $130.7 million and $69.3 million, respectively, and the interest rate on the balance outstanding was 7.01%. At June 30, 1999, the bank consortium had not committed, nor had the Company borrowed, any funds under the uncommitted $100.0 million portion of the Senior Credit Facility.

The Company's working capital was $15.0 million and $10.2 million at June 30, 1999 and December 31, 1998, respectively. The Company's cash provided from operations was $6.5 million and $8.4 million for the six months ended June 30, 1999 and 1998, respectively.

The Company's cash used in investing activities was $22.7 million and $8.0 million for the six months ended June, 1999 and 1998, respectively. The increased usage of $14.7 million from 1998 to 1999 was primarily due to the Goshen Acquisition.

The Company's cash provided by financing activities was $19.5 million for the six months ended June 30, 1999 and the cash used in financing activities was $79,000 for the same period of the prior year. The increase in cash provided by financing activities resulted from increased borrowings under the Senior Credit Facility, primarily to fund the Goshen Acquisition.

During the six months ended June 30, 1999, the Company issued 26,427 shares of Class B Common Stock from treasury to fulfill obligations under its employee benefit plan. The Company also purchased 20,000 shares of Class B Common Stock for $257,004 during the six months ended June 30, 1999.

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 six months ended June 30, 1999, the Company paid $2.4 million for such program broadcast rights.

The Company and its subsidiaries file a consolidated federal income tax return and such state or local tax returns as are required. As of June 30, 1999, the Company anticipates that it will generate operating losses for the foreseeable future.

On April 14, 1999, the Company announced that it had entered into agreements to acquire the CBS affiliates KWTX-TV ("KWTX") located in Waco, Texas and KBTX-TV ("KBTX"), a satellite station of KWTX located in Bryan, Texas. In addition, the Company has agreed to acquire KXII-TV ("KXII"), which is the CBS affiliate serving Sherman, Texas and Ada, Oklahoma. These transactions are referred to herein as the "Texas Acquisition." Aggregate consideration for the Texas Acquisition will be approximately $139 million before payment for certain net working capital amounts and other fees and expenses. The aggregate consideration for KWTX and KBTX will be $97.5 million before consideration for certain net working capital amounts. The amount of consideration paid in shares of the Company's Class B Common Stock will not be less than 40% of the aggregate consideration for KWTX and KBTX. The Company will acquire substantially all of the assets of KXII for $41.5 million in cash plus cash payments for certain accounts receivable.

The total amount of funds required by the Company to consummate the Texas Acquisition and pay related fees and expenses is estimated to be approximately $100.0 million. The Company currently intends to issue long-term senior debt to fund the Texas Acquisition. While exact financing terms have not been finalized, the Company currently believes the financing will have a principal amount of $100.0 million and have a variable interest rate based upon LIBOR plus an additional percentage based upon the Company's overall ratio of indebtedness to its operating cash flow. The Company currently expects the principal will be repaid in scheduled quarterly installments with the final payment becoming due prior to October 1, 2006. The Company anticipates that the indebtedness will

LIQUIDITY AND CAPITAL RESOURCES (Continued)

be senior secured indebtedness of the Company and that the Company and its subsidiaries will jointly and severally pledge their assets to guarantee the indebtedness. This additional indebtedness will also contain covenants that are similar to those in the existing Senior Credit Facility.

The actual amount of cash that will be needed to complete the Texas Acquisition can only be estimated at this time and it is dependent upon several factors contained in the related acquisition agreements: (1) the proportion of cash and Class B Common Stock elected to be received by the shareholders of KWTX and KBTX, (2) working capital amounts and (3) the actual amount of the transaction and closing costs. If the shareholders of KWTX and KBTX were to elect to receive more than 40% of their respective consideration in Class B Common Stock, the amount of cash requiring financing would be reduced. The Company has the option, in certain limited circumstances, to pay all of the consideration for KWTX and KBTX in cash for an aggregate price of $95.5 million plus certain net working capital amounts. If the Company elects to pay all such consideration in cash, then it would require a minimum of $37 million in additional financing from existing credit facilities or other sources of capital.

The Company will require modifications to its existing Senior Credit Facility to allow for, among other things, the expected increase in the Company's total indebtedness and the issuance of the planned additional senior debt. Such modifications will require the approval of over two-thirds of the Senior Credit Facility's participants. The Company currently believes such approval will be obtained. If the approval were not obtained, the Company would explore alternate financing arrangements.

On January 28, 1999, Bull Run Corporation ("Bull Run"), a principal shareholder of the Company, acquired 301,119 shares of the common stock of Sarkes Tarzian, Inc. ("Tarzian") from the Estate of Mary Tarzian (the "Estate") for $10.0 million. These shares (the "Tarzian Shares") represent 33.5% of the total outstanding common stock of Tarzian (both in terms of the number of shares of common stock outstanding and in terms of voting rights), but such investment represents 73% of the equity of Tarzian for purposes of dividends as well as distributions in the event of any liquidation, dissolution or other termination of Tarzian.

The Company has an option agreement with Bull Run, whereby the Company has the option to acquire the Tarzian Shares from Bull Run for an amount equal to Bull Run's purchase price for the Tarzian Shares and related costs. The option agreement expired on May 31, 1999, however, the Company extended the option period with Bull Run through September 30, 1999 at a cost of $266,800. However, if the Company has not exercised its option to acquire the Tarzian Shares prior to September 30, 1999, the Company plans to extend the option period in increments of 30 days. The Company can extend the option period until December 31, 2000 at a cost of $66,700 per 30 day extension. Neither Bull Run's investment nor the Company's potential investment is presently attributable under the ownership rules of the Federal Communications Commission. If the Company exercises the option agreement, the Company plans to fund the acquisition through its Senior Credit Facility.

Management believes that current cash balances, cash flow from operations, borrowings under its Senior Credit Facility and additional borrowings necessary to complete the Texas Acquisition will be adequate to provide for the Company's capital expenditures, debt service, cash dividends and working capital requirements for the forseeable future.

Management 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.

IMPACT OF YEAR 2000

The problems created by systems that are unable to interpret dates accurately after December 31, 1999 is referred to as the "Year 2000 Issue." Many software programs have historically categorized the "year" in a two-digit format rather than a four-digit format. As a result, those computer programs that have time-sensitive software

IMPACT OF YEAR 2000 (Continued)

may recognize a date using "00" as the year 1900 rather than the year 2000. The Year 2000 Issue creates potential risks for the Company, including potential problems in the Company's Information Technology ("IT") and non-IT systems. The Year 2000 Issue could cause a system failure, miscalculations or disruptions of operations, including, among other things, a temporary inability to process transactions, send invoices, or engage in similar normal business activities. The Company may also be exposed to risks from third parties who fail to adequately address their own Year 2000 Issue.

The Company has implemented a multiphase program designed to address the Year 2000 Issue. Each phase of this program and its state of completion are described below:

ASSESSMENT: This phase of the program includes the identification of the Company's IT and non-IT systems. After these systems have been identified, they are evaluated to determine whether they will correctly recognize dates after December 31, 1999 ("Year 2000 Compliant"). If it is determined that they are not Year 2000 Compliant, they are replaced or modified in the Remediation phase of the program. The majority of the Company's systems are non-proprietary.

The Company is in the process of obtaining from each system vendor a written or oral representation as to each significant system's status of compliance. The Company has commenced an ongoing process of contacting suppliers and other key third parties to assess their Year 2000 Compliance status. It appears that all of these third parties are currently Year 2000 Compliant or they plan to be Year 2000 Compliant prior to December 31, 1999. This phase is substantially complete and the Company has identified the majority of the systems that need to be replaced.

REMEDIATION: For those systems that are not Year 2000 Compliant, a plan is derived to make the systems Year 2000 Compliant. These solutions have included modification or replacement of existing systems. The Remediation phase is approximately 75% complete and the Company anticipates that it will be completed by November 1, 1999.

TESTING: Test remediated systems to assure normal function when placed in their original operating environment and further test for Year 2000 Compliance. The Testing phase of the program is approximately 70% complete and the Company anticipates that it will be completed by November 30, 1999.

CONTINGENCY: As a result of the Company's Year 2000 Compliance program, the Company does not believe that it has significant risk resulting from this issue. However, the Company is in the process of developing contingency plans for the possibility that one of its systems or a third party's systems may not be Year 2000 Compliant. The Company believes that the most reasonable likely worst case scenario is a temporary loss of functionality at one or more of the Company's operating units. In the unlikely event that this was to occur, the Company would experience decreased revenue and slightly higher operating costs at the affected location. However, due to the decentralized nature of the Company's operations, it is not likely that all locations would be affected by a single non-functioning system.

The Company does not presently believe that the estimated total Year 2000 project cost will exceed $750,000. Most of this cost will be realized over the estimated useful lives of the new hardware and software; however, any third party consulting fees would be expensed in the period the services are rendered. To date, the Company has identified several minor systems that are not Year 2000 Compliant and these systems are in the process of being replaced. However, the Company has not incurred significant expenses associated with the Year 2000 Issue. As of June 30, 1999, no IT projects have been deferred due to the Company's efforts related to the Year 2000 Issue.

IMPACT OF YEAR 2000 (Continued)

The costs of the project and the date on which the Company believes it will complete the Year 2000 modifications are based on management's best estimates, which were derived utilizing numerous assumptions of future events, including the continued availability of certain resources and other factors. However, there can be no guarantee that these estimates will be achieved and actual results could differ materially from those anticipated. Specific factors that might cause such material differences include, but are not limited to, the availability and cost of personnel trained in this area, the ability to locate and correct all relevant computer codes, and similar uncertainties.

CAUTIONARY STATEMENTS FOR PURPOSES OF THE "SAFE HARBOR" PROVISIONS OF THE PRIVATE SECURITIES LITIGATION REFORM ACT

This quarterly report on Form 10-Q contains "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. When used in this report, the words "believes," "expects," "anticipates," "estimates" and similar words and expressions are generally intended to identify forward-looking statements. Statements that describe the Company's future strategic plans, goals, or objectives are also forward-looking statements. Readers of this report are cautioned that any forward-looking statements, including those regarding the intent, belief or current expectations of the Company or management, are not guarantees of future performance, results or events and involve risks and uncertainties, and that actual results and events may differ materially from those in the forward-looking statements as a result of various factors including, but not limited to, (i) general economic conditions in the markets in which the Company operates, (ii) competitive pressures in the markets in which the Company operates, (iii) the effect of future legislation or regulatory changes on the Company's operations and (iv) other factors described from time to time in the Company's filings with the Securities and Exchange Commission. The forward-looking statements included in this report are made only as of the date hereof. The Company undertakes no obligation to update such forward-looking statements to reflect subsequent events or circumstances.

PART II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

27 - Financial Data Schedule

(b) Reports on Form 8-K

None

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: August 4, 1999

By: /s/ James C. Ryan

James C. Ryan,
Vice President - Finance &
Chief Financial Officer

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This schedule contains summary financial information extracted from the June 30, 1999 unaudited condensed consolidated financial statements of Gray Communications Systems, Inc., and is qualified in its entirety by reference to such financial statements.

0000043196
GRAY COMMUNICATIONS SYSTEMS, INC.
1
US DOLLARS

6-MOS
DEC-31-1999
JAN-01-1999
JUN-30-1999
1
5,084,986
0
24,034,187
1,239,269
877,689
32,563,896
86,889,596
34,005,075
480,827,713
17,542,022
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13,500,000
67,570,193
42,112,478
480,827,713
66,621,239
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13,774,671
(3,324,830)
(684,000)
(2,640,830)
0
0
0
(3,145,832)
(0.26)
(0.26)