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 MARCH 31, 1998.

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)

126 N. 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)	CLASS B COMMON STOCK, (NO PAR VALUE)
4,537,695 SHARES AS OF MAY 8, 1998	3,407,204 SHARES AS OF MAY 8, 1998

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	MARCH 31, 1998	DECEMBER 31, 1997
CURRENT ASSETS:		
Cash and cash equivalents	$ 1,051,009	$ 2,367,300
Trade accounts receivable, less allowance for doubtful accounts of $1,295,000 and $1,253,000, respectively	18,288,309	19,527,316
Recoverable income taxes	2,047,980	2,132,284
Inventories	1,137,514	846,891
Current portion of program broadcast rights	2,129,358	2,850,023
Other current assets	1,687,008	968,180
Total current assets	26,341,178	28,691,994
PROPERTY AND EQUIPMENT:		
Land	1,050,448	889,696
Buildings and improvements	11,896,511	11,951,700
Equipment	53,926,757	52,899,547
	66,873,716	65,740,943
Allowance for depreciation	(24,201,474)	(23,635,256)
	42,672,242	42,105,687
OTHER ASSETS:		
Deferred loan costs	8,257,975	8,521,356
Goodwill and other intangibles	261,972,682	263,425,447
Other	3,090,861	2,306,143
	273,321,518	274,252,946
	$342,334,938	$345,050,627

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

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

	MARCH 31, 1998	DECEMBER 31, 1997
CURRENT LIABILITIES:		
Trade accounts payable (includes $600,000 and $850,000 payable to Bull Run Corporation, respectively)	$ 3,987,854	$ 3,321,903
Employee compensation and benefits	3,296,662	3,239,694
Accrued expenses	2,144,833	2,265,725
Accrued interest	8,855,834	4,533,366
Current portion of program broadcast obligations	2,067,007	2,876,060
Deferred revenue	2,095,903	1,966,166
Current portion of long-term debt	573,340	400,000
Total current liabilities	23,021,433	18,602,914
LONG-TERM DEBT	220,915,482	226,676,377
OTHER LONG-TERM LIABILITIES:		
Program broadcast obligations, less current portion	416,647	617,107
Supplemental employee benefits	1,086,367	1,161,218
Deferred income taxes	1,101,728	1,203,847
Other acquisition related liabilities	4,283,376	4,494,016
	6,888,118	7,476,188
Commitments and contingencies		
STOCKHOLDERS' EQUITY:		
Serial Preferred Stock, no par value; authorized 20,000,000 shares; issued 2,060 shares ($20,600,000 aggregate liquidation value)	20,600,000	20,600,000
Class A Common Stock, no par value; authorized 15,000,000 shares; issued 5,307,716 shares	10,404,874	10,358,031
Class B Common Stock, no par value; authorized 15,000,000 shares; issued 3,515,364 shares	66,593,805	66,397,804
Retained earnings	4,517,915	6,603,191
	102,116,594	103,959,026
Treasury Stock at cost, Class A Common, 773,521 and 781,921 shares, respectively	(8,843,492)	(9,011,369)
Treasury Stock at cost, Class B Common, 110,870 and 166,790 shares, respectively	(1,763,197)	(2,652,509)
	91,509,905	92,295,148
	$342,334,938	$345,050,627

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

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

	THREE MONTHS ENDED MARCH 31,	
	1998	1997
OPERATING REVENUES		
Broadcasting (net of agency commissions)	$ 19,511,064	$ 15,985,297
Publishing	6,537,335	5,224,854
Paging	1,933,466	1,550,376
	27,981,865	22,760,527
EXPENSES		
Broadcasting	12,118,387	9,694,784
Publishing	5,457,505	3,933,421
Paging	1,255,605	890,294
Corporate and administrative	660,480	633,328
Depreciation and amortization	3,621,584	3,271,943
	23,113,561	18,423,770
	4,868,304	4,336,757
Miscellaneous expense	241,067	45,763
	4,627,237	4,290,994
Interest expense	5,927,481	4,975,693
LOSS BEFORE INCOME TAXES	(1,300,244)	(684,699)
Income tax expense (benefit)	182,563	(223,600)
NET LOSS	(1,482,807)	(461,099)
Preferred Dividends	358,998	350,000
NET LOSS AVAILABLE TO COMMON STOCKHOLDERS	$ (1,841,805)	$ (811,099)
AVERAGE OUTSTANDING COMMON SHARES:		
Basic	7,920,428	7,947,284
Diluted	7,920,428	7,947,284
BASIC LOSS PER COMMON SHARE:		
Net loss available to common stockholders	$ (0.23)	$ (0.10)
DILUTED LOSS PER COMMON SHARE:		
Net loss available to common stockholders	$ (0.23)	$ (0.10)

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

	Preferred Stock		Class A Common Stock		Class B Common Stock	
	Shares	Amounts	Shares	Amounts	Shares	Amounts
Balance at December 31, 1997	2,060	$ 20,600,000	5,307,716	$ 10,358,031	3,515,364	$ 66,397,804
Net loss for the three months ended March 31, 1998						
Common stock dividends ($.02 per share)						
Preferred stock dividends						
Income tax benefits relating to stock plans				46,843		166,550
Issuance of treasury stock:						
401 (k) plan						29,451
Non-qualified stock plan						
Balance at March 31, 1998	2,060	$ 20,600,000	5,307,716	$ 10,404,874	3,515,364	$ 66,593,805

	Retained Earnings	Class A Treasury Stock		Class B Treasury Stock		Total
		Shares	Amounts	Shares	Amounts	
Balance at December 31, 1997	$ 6,603,191	(781,921)	$ (9,011,369)	(166,790)	$(2,652,509)	$ 92,295,148
Net loss for the three months ended March 31, 1998	(1,482,807)					(1,482,807)
Common stock dividends ($.02 per share)	(158,609)					(158,609)
Preferred stock dividends	(358,998)					(358,998)
Income tax benefits relating to stock plans						213,393
Issuance of treasury stock:						
401 (k) plan				3,420	54,389	83,840
Non-qualified stock plan	(84,862)	8,400	167,877	52,500	834,923	917,938
Balance at March 31, 1998	$ 4,517,915	(773,521)	$(8,843,492)	(110,870)	$(1,763,197)	$ 91,509,905

SEE NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.

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

	THREE MONTHS ENDED MARCH 31,	
	1998	1997
OPERATING ACTIVITIES		
Net loss	$ (1,482,807)	$ (461,099)
Items which did not use (provide) cash:		
Depreciation	1,827,823	1,712,147
Amortization of intangible assets	1,793,761	1,559,796
Amortization of deferred loan costs	271,174	269,074
Amortization of program broadcast rights	940,319	796,817
Payments for program broadcast rights	(995,668)	(938,009)
Supplemental employee benefits	(74,851)	(66,941)
Common Stock contributed to 401(k) Plan	83,840	117,573
Deferred income taxes	(102,119)	1,662,000
Loss on disposal of assets	260,930	-0-
Changes in operating assets and liabilities:		
Receivables, inventories and other current assets	272,743	275,971
Accounts payable and other current liabilities	4,850,232	2,243,865
NET CASH PROVIDED BY OPERATING ACTIVITIES	7,645,377	7,171,194
INVESTING ACTIVITIES		
Purchase of FCC license	(829,600)	-0-
Purchases of property and equipment	(2,656,786)	(4,206,376)
Deferred acquisition costs	(93,972)	(78,369)
Payments on purchase liabilities	(210,640)	(93,848)
Other	(355,839)	(148,919)
NET CASH USED IN INVESTING ACTIVITIES	(4,146,837)	(4,527,512)
FINANCING ACTIVITIES		
Dividends paid	(358,607)	(354,113)
Class A Common Stock transactions	46,843	45,895
Class B Common Stock transactions	166,550	-0-
Proceeds from sale of treasury shares	917,938	-0-
Proceeds from borrowings of long-term debt	500,000	-0-
Payments on long-term debt	(6,087,555)	(3,032,004)
NET CASH USED IN FINANCING ACTIVITIES	(4,814,831)	(3,340,222)
DECREASE IN CASH AND CASH EQUIVALENTS	(1,316,291)	(696,540)
Cash and cash equivalents at beginning of period	2,367,300	1,051,044
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 1,051,009	$ 354,504

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 three month period ended March 31, 1998 are not necessarily indicative of the results that may be expected for the year ending December 31, 1998. 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, 1997.

Certain amounts in the accompanying unaudited condensed consolidated financial statements have been reclassified to conform to the 1998 format.

NOTE B--BUSINESS ACQUISITIONS

Pending Acquisitions

On May 4, 1998, Cosmos Broadcasting Corporation ("Cosmos"), a subsidiary of the Liberty Corporation signed a letter of intent to acquire WALB-TV, the Company's NBC affiliate operating on Channel 10 in Albany, Georgia in a transaction valued at approximately $78.0 million. Under the proposed agreement, Cosmos will purchase a Wisconsin television station that the Company had intended to acquire and exchange it for WALB-TV in a like-kind exchange transaction. The station, WEAU-TV the NBC-affiliate operating on Channel 13 serving the Eau Claire-La Crosse market, is currently owned by Busse Broadcasting Corporation. On February 13, 1998, the Company signed a definitive purchase agreement to acquire all of the outstanding capital stock of Busse Broadcasting Corporation ("Busse"). The purchase price is approximately $112.0 million plus Busse's cash and cash equivalents less Busse's indebtedness including its 11 5/8% Senior Secured Notes due 2000. Busse owns and operates three VHF television stations: KOLN-TV, the CBS-affiliate operating on Channel 10 in the Lincoln-Hastings-Kearney, Nebraska television market, and its satellite station KGIN-TV, the CBS-affiliate operating on Channel 11 serving Grand Island, Nebraska; and WEAU-TV. The exchange of WALB-TV for WEAU-TV and the purchase of Busse is subject to FCC approval. These transactions are expected to close on or before September 1, 1998. In connection with the proposed exchange of WALB-TV for WEAU-TV and the purchase of Busse, the Company will pay Bull Run Corporation, a principal stockholder of the Company, a finder's fee equal to 1% of the transaction values for services performed, none of which was due and included in accounts payable at March 31, 1998.

Condensed unaudited balance sheets of WALB-TV as of March 31, 1998 and December 31, 1997 are as follows:

	MARCH 31, 1998	DECEMBER 31, 1997
	(IN THOUSANDS)	
Current assets	$ 2,104	$ 2,379
Property and equipment, net	1,448	1,473
Other assets	756	471
Total assets	$ 4,308	$ 4,323
Current liabilities	$ 1,332	$ 994
Other liabilities	192	215
Stockholder's equity	2,784	3,114
Total liabilities and stockholder's equity	$ 4,308	$ 4,323

Condensed unaudited income statement data for the three months ended March 31, 1998 and 1997 for WALB-TV are as follows:

	THREE MONTHS ENDED MARCH 31,	
	1998	1997
	(IN THOUSANDS)	
Broadcasting revenues	$ 2,423	$ 2,347
Expenses	1,137	1,093
Income before income taxes	$ 1,286	$ 1,254
Net income	$ 797	$ 777

1997 ACQUISITIONS

On April 24, 1997, the Company purchased GulfLink Communications, Inc. and on August 1, 1997, the Company purchased the assets of WITN-TV. Assuming that these acquisitions had been completed on January 1, 1997, on a pro forma basis for the three months ended March 31, 1997, the Company reported revenue, net loss available to common stockholders and diluted net loss per share available to common stockholders of $25.3 million, $1.2 million and $0.15, respectively.

NOTE C--LONG-TERM DEBT

In September 1996, the Company entered into the $125.0 million senior credit facility (the "Senior Credit Facility") with KeyBank National Association, NationsBank, N.A. (South), CIBC, Inc., CoreStates Bank, N.A., and the Bank of New York. The Senior Credit Facility included scheduled reductions in the $125.0 million credit limit which commenced on March 31, 1997, interest rates based upon a spread over LIBOR and/or Prime, an unused commitment fee of 0.50% applied to available funds and a maturity date of June 30, 2003. Effective September 17, 1997, the Senior Credit Facility was modified to reinstate the original credit limit of $125.0 million which had been reduced by the scheduled reductions. The modification also reduced the interest rate spread over LIBOR and/or Prime and reduced the fee applied to available funds from 0.50% to 0.375%. The modification also extended the maturity date from June 30, 2003 to June 30, 2004. The modification required a one-time fee of $250,000. At March 31, 1998, the Company had approximately $60.1 million outstanding under the Senior Credit Facility, which did not include a letter of credit in the amount of $5.9 million which had been established but not yet drawn upon. On March 31, 1998, the balance available under the Senior Credit Facility was $57.2 million and the interest rate on the balance outstanding was based on a spread over LIBOR and Prime of 2.00% and 0.25%, respectively. As of March 31, 1998, the credit limit of $125.0 million as amended on September 17, 1997 had been reduced by $1.8 million due to scheduled reductions as specified in the Senior Credit Facility.

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.

The Company derives its revenues from its television broadcasting, publishing and paging operations. On August 1, 1997 the Company purchased substantially all of the assets of WITN-TV ("WITN"), the NBC affiliate in the Greenville-Washington-New Bern, North Carolina market (the "WITN Acquisition"). On April 24, 1997, the Company purchased GulfLink Communications, Inc. (the "GulfLink Acquisition"), which is in the transportable satellite uplink business, a business in which the Company was already engaged. 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 contributions of the Company's publishing and paging operations. Set forth below, for the periods indicated, is certain information concerning the relative contributions of the Company's television broadcasting, publishing and paging operations.

	THREE MONTHS ENDED MARCH 31,			
	1998		1997	
	AMOUNT	PERCENT OF TOTAL	AMOUNT	PERCENT OF TOTAL
	(DOLLARS IN THOUSANDS)			
TELEVISION BROADCASTING				
Revenues	$ 19,511	69.7%	$ 15,985	70.2%
Operating income (1)	4,336	78.2	3,761	75.5
PUBLISHING				
Revenues	$ 6,537	23.4%	$ 5,225	23.0%
Operating income (1)	944	17.0	887	17.8
PAGING				
Revenues	$ 1,934	6.9%	$ 1,551	6.8%
Operating income (1)	268	4.8	333	6.7

(1) Represents income before miscellaneous income (expense), allocation of corporate overhead, interest expense and income taxes.

The operating revenues of the Company's television stations are derived primarily from broadcast advertising revenues and, to a much lesser extent, from compensation paid by the networks to the stations for broadcasting network programming. The operating revenues of the Company's publishing operations are derived from retail advertising, circulation and classified revenue. Paging revenue is derived primarily from the leasing and sale of pagers.

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 Media Research ("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

RESULTS OF OPERATIONS (CONTINUED)

INTRODUCTION (CONTINUED)

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. Approximately 55.6% of the gross revenues of the Company's television stations for the three months ended March 31, 1998 were generated from local advertising, which is sold primarily by a station's sales staff directly to local accounts, and the remainder represented primarily national advertising, which is sold by a station's national advertising sales representative. The stations generally pay commissions to advertising agencies on local, regional and national advertising. 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 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, which spending typically is heaviest during the fourth quarter.

The Company's publishing operations' advertising contracts are generally entered into annually and provide for a commitment as to the volume of advertising to be purchased by an advertiser during the year. The publishing operations' advertising revenues are primarily generated from local advertising. As with the broadcasting operations, the publishing operations' revenues are generally highest in the second and fourth quarters of each year.

The Company's paging subscribers either own pagers, thereby paying solely for the use of the Company's paging services, or lease pagers, thereby paying a periodic charge for both the pagers and the paging services. Of the Company's pagers currently in service, approximately 75% are owned and maintained by subscribers with the remainder being leased. The terms of the lease contracts are month-to-month, three months, nine months or twelve months in duration. Paging revenues are generally equally distributed throughout the year.

The broadcasting operations' primary operating expenses are employee compensation, related benefits and programming costs. The publishing operations' primary operating expenses are employee compensation, related benefits and newsprint costs. The paging operations' primary operating expenses are employee compensation and telephone and other communications costs. In addition, the broadcasting, publishing and paging operations incur overhead expenses, such as maintenance, supplies, insurance, rent and utilities. A large portion of the operating expenses of the broadcasting, publishing and paging 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 the broadcast, publishing and paging operations for the three months ended March 31, 1998 and 1997:

	THREE MONTHS ENDED MARCH 31, 1998	THREE MONTHS ENDED MARCH 31, 1997
	(IN THOUSANDS)	
Operating income	$ 4,868	$ 4,337
Add:		
Amortization of program license rights	940	797
Depreciation and amortization	3,622	3,272
Corporate overhead	661	633
Non-cash compensation and contributions to the Company's 401(k) plan, paid in common stock	117	114
Less:		
Payments for program license liabilities	(996)	(938)
Media Cash Flow (1)	$ 9,212	$ 8,215

(1) Of Media Cash Flow for the three months ended March 31, 1998 and 1997, $7.4 million and $6.2 million, respectively, was attributable to the Company's broadcasting operations; $1.1 million and $1.3 million, respectively, was attributable to the Company's publishing operations; and $687,000 and $667,000, respectively, was attributable to the Company's paging operations

"Media Cash Flow" is defined as operating income, 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 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 unaudited Condensed Consolidated Financial Statements, 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.

As discussed in the INTRODUCTION, the Company completed two broadcasting acquisitions during 1997. The financial results of the Company reflect increases between the three month period ended March 31, 1998 and 1997 in substantially all broadcast line items.

CASH FLOW PROVIDED BY (USED IN) OPERATING, INVESTING AND FINANCING ACTIVITIES

The following table sets forth certain cash flow data for the Company for the three months ended March 31, 1998 and 1997.

	THREE MONTHS ENDED MARCH 31, 1998	THREE MONTHS ENDED MARCH 31, 1997
	(IN THOUSANDS)	
Cash flows provided by (used in)		
Operating activities	$ 7,645	$ 7,171
Investing activities	(4,147)	(4,528)
Financing activities	(4,815)	(3,340)

ITEM 2. 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 MARCH 31,			
	1998		1997	
	AMOUNT	PERCENT OF TOTAL	AMOUNT	PERCENT OF TOTAL
	(DOLLARS IN THOUSANDS)			
BROADCASTING NET REVENUES:				
Local	$ 10,898	38.9%	$ 9,112	40.0%
National	5,570	19.9	4,765	20.9
Network compensation	1,215	4.3	1,133	5.0
Political	193	0.7	47	0.2
Production and other	1,635	5.9	928	4.1
	$ 19,511	69.7%	$ 15,985	70.2%
PUBLISHING NET REVENUES:				
Retail advertising	$ 2,977	10.6%	$ 2,490	10.9%
Classified	2,085	7.5	1,617	7.1
Circulation	1,279	4.6	990	4.3
Other	196	0.7	128	0.7
	$ 6,537	23.4%	$ 5,225	23.0%
PAGING NET REVENUES:				
Paging lease and service	$ 1,934	6.9%	$ 1,551	6.8%
	$ 27,982	100.0%	$ 22,761	100.0%

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

THREE MONTHS ENDED MARCH 31, 1998 COMPARED TO THREE MONTHS ENDED MARCH 31, 1997

REVENUES. Total revenues for the three months ended March 31, 1998 increased $5.2 million, or 22.9%, over the same period of the prior year, to $28.0 million from $22.8 million. This increase was primarily attributable to the net effect of (i) increased revenues resulting from the WITN Acquisition and the GulfLink Acquisition, (ii) increased publishing revenues and (iii) increased paging revenues. The WITN Acquisition and the GulfLink Acquisition accounted for $1.9 million and $699,000, respectively, of the revenue increase.

Broadcast net revenues increased $3.5 million, or 22.1%, over the same period of the prior year, to $19.5 million from $16.0 million. The WITN Acquisition and the GulfLink Acquisition accounted for $1.9 million and $699,000, respectively, of the broadcast net revenue increase. On a pro forma basis, assuming the acquisition of WITN had been effective on January 1, 1997, broadcast net revenues for WITN for the three months ended March 31, 1998 increased $111,000, or 6.3%, when compared to the same period of the prior year to $1.9 million from $1.8 million. Broadcast net revenues, excluding the WITN Acquisition and the GulfLink Acquisition, increased $963,000, or 6.0%, over the same period of the prior year, to $16.9 million from $16.0 million. This increase was due primarily to an increase in local advertising revenue of $722,000.

Publishing revenues increased $1.3 million, or 25.1%, over the same period of the prior year, to $6.5 million from $5.2 million. The increase in revenues was due primarily to an increase in retail advertising, classified advertising, circulation and other revenue of $487,000, $468,000 $289,000 and $68,000, respectively. The increase in retail advertising and circulation revenue was due primarily to an increase in circulation at the Gwinnett Daily Post to 64,000 at March 31, 1998 from 13,000 at March 31, 1997. The increase in classified advertising revenue was due primarily to rate and linage increases. The increase in other revenue was due primarily to increased commercial printing revenue and increased other advertising revenue.

Paging revenue increased $383,000 or 24.7%, over the same period of the prior year, to $1.9 million from $1.6 million. The increase was attributable primarily to an increase in the number of pagers in service. The Company had approximately 73,000 pagers and 54,000 pagers in service at March 31, 1998 and 1997, respectively.

OPERATING EXPENSES. Operating expenses for the three months ended March 31, 1998 increased $4.7 million, or 25.5%, over the same period of the prior year, to $23.1 million from $18.4 million, due primarily to the WITN Acquisition, the GulfLink Acquisition, and the expense associated with the increase in circulation at the Gwinnett Daily Post. The WITN Acquisition, the GulfLink Acquisition and the cost associated with the increase in circulation at the Gwinnett Daily Post accounted for $1.2 million, $588,000 and $1.5 million (exclusive of depreciation and amortization), respectively, of the operating expense increase.

Broadcast expenses increased $2.4 million, or 25.0%, over the three months ended March 31, 1998, to $12.1 million from $9.7 million. The increase was attributable primarily to the WITN Acquisition and GulfLink Acquisition. On a pro forma basis, assuming the acquisition of WITN had been effective on January 1, 1997, broadcast expenses for WITN for the three months ended March 31, 1998 increased $82,000, or 7.3%, over the three months ended March 31, 1997 to $1.2 million from $1.1 million. Broadcast expenses, excluding the results of the WITN Acquisition and the GulfLink Acquisition, increased $633,000, or 6.5%, to $10.3 million from $9.7 million. This increase was due primarily to an increase in payroll expense of $482,000.

Publishing expenses for the three months ended March 31, 1998 increased $1.5 million, or 38.8%, from the same period of the prior year, to $5.5 million from $3.9 million. This increase resulted primarily from an increase in the expense associated with the increase in circulation at the Gwinnett Daily Post and higher newsprint pricing. Average newsprint costs increased approximately 11.1% while newsprint consumption increased approximately 33.9%.

Paging expenses increased $366,000 or 41.1%, over the same period of the prior year, to $1.3 million from $890,000. The increase was attributable primarily to an increase in the number of pagers in service.

THREE MONTHS ENDED MARCH 31, 1998 COMPARED TO THREE MONTHS ENDED MARCH 31, 1997 (CONTINUED)

Corporate and administrative expenses for the three months ended March 31, 1998 and the three months ended March 31, 1997, were approximately $650,000.

Depreciation of property and equipment and amortization of intangible assets was $3.6 million for the three months ended March 31, 1998, as compared to $3.3 million for the same period of the prior year, an increase of $350,000, or 10.7%. This increase was primarily the result of higher depreciation and amortization costs related to the WITN Acquisition and the GulfLink Acquisition.

INTEREST EXPENSE. Interest expense increased $951,000, or 19.1%, to $5.9 million for the three months ended March 31, 1998 from $5.0 million for the three months ended March 31, 1997. This increase was attributable primarily to increased levels of debt resulting from the financing of the WITN Acquisition and the GulfLink Acquisition.

INCOME TAX EXPENSE (BENEFIT). Income tax expense for the three months ended March 31, 1998 was 183,000 and income tax benefit for the three months ended March 31, 1997 was $224,000. The increase in income tax expense of $407,000 was due primarily to the utilization of all benefits from available net operating loss carrybacks in 1997.

NET LOSS AVAILABLE TO COMMON STOCKHOLDERS. Net loss available to common stockholders of the Company was $1.8 million for the three months ended March 31, 1998, as compared with net loss of $811,000 for the same period of the prior year, an increase of $1.0 million.

LIQUIDITY AND CAPITAL RESOURCES

In September 1996, the Company entered into the $125.0 million senior credit facility (the "Senior Credit Facility") with KeyBank National Association, NationsBank, N.A. (South), CIBC, Inc., CoreStates Bank, N.A., and the Bank of New York. The Senior Credit Facility included scheduled reductions in the $125.0 million credit limit which commenced on March 31, 1997, interest rates based upon a spread over LIBOR and/or Prime, an unused commitment fee of 0.50% applied to available funds and a maturity date of June 30, 2003. Effective September 17, 1997, the Senior Credit Facility was modified to reinstate the original credit limit of $125.0 million which had been reduced by the scheduled reductions. The modification also reduced the interest rate spread over LIBOR and/or Prime and reduced the fee applied to available funds from 0.50% to 0.375%. The modification also extended the maturity date from June 30, 2003 to June 30, 2004. The modification required a one-time fee of $250,000. At March 31, 1998, the Company had approximately $60.1 million outstanding on the Senior Credit Facility, which did not include a letter of credit in the amount of $5.9 million which had been established but not yet drawn upon. On March 31, 1998, the balance available under the Senior Credit Facility was $57.2 million and the interest rate on the balance outstanding was based on a spread over LIBOR and Prime of 2.00% and 0.25%, respectively. As of March 31, 1998, the credit limit of $125.0 million as amended on September 17, 1997 had been reduced by $1.8 million due to scheduled reductions as specified in the Senior Credit Facility.

The Company's working capital was $3.3 million and $10.1 million at March 31, 1998 and December 31, 1997, respectively. The Company's cash provided from operations was $7.6 million and $7.2 million for the three months ended March 31, 1998 and 1997, respectively. Management believes that current cash balances, cash flows from operations and the available funds under its Senior Credit Facility will be adequate to provide for the Company's capital expenditures, debt service, cash dividends and working capital requirements for the forseeable future. The Senior Credit Facility contains certain restrictive provisions, which, among other things, limit capital expenditures and additional indebtedness and require minimum levels of cash flows. Additionally, the effective interest rate of the Senior Credit Facility can be changed based upon the Company's maintenance of certain operating ratios as defined in the Senior Credit Facility, not to exceed the lender's prime rate plus 0.5% or LIBOR plus 2.25%. The Senior Credit Facility contains restrictive provisions similar to the provisions of the Company's 10 5/8% Senior Subordinated Notes due 2006.

LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)

The Company's cash used in investing activities was $4.1 million and $4.5 million for the three months ended March 31, 1998 and 1997, respectively. The decreased usage of $381,000 from 1997 to 1998 was primarily due to the payment of $829,600 to the Federal Communications Commission for a special mobile radio license ("SMR") partially offset by decreased capital expenditures in 1998.

The Company's cash used in financing activities was $4.8 million and $3.3 million for the three months ended March 31, 1998 and 1997, respectively. The increase in cash used by financing activities resulted primarily from increased payments on long term debt partially offset by funds provided by common stock transactions. During the three months ended March 31, 1998, the Company issued 8,400 shares of Class A Common Stock and 55,920 shares of Class B Common Stock from treasury to fulfill obligations under its employee benefit plan, non-employee director stock purchase plan and long-term incentive plan.

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, 1998, the Company paid $996,000 for such program broadcast rights.

In connection with the acquisition of WCTV-TV during 1996, the FCC ordered the Company to divest itself of WALB-TV in Albany, Georgia and WJHG-TV in Panama City, Florida by March 31, 1997 to comply with regulations governing common ownership of television stations with overlapping service areas. The FCC is currently reexamining these regulations, and if it revises them in accordance with the interim policy it has adopted, divestiture of WJHG-TV would not be required. Accordingly, the Company requested and in July of 1997 received an extension of the divestiture deadline with regard to WJHG-TV conditioned upon the outcome of the rulemaking proceedings. It can not be determined when the FCC will complete its rulemaking on this subject. Also in July of 1997, the Company obtained FCC approval to transfer control of WALB-TV to a trust with a view towards the trustee effecting (i) a swap of WALB-TV's 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 Internal Revenue Code of 1986, or (ii) a sale of such assets. Under the trust arrangement, the Company relinquished operating control of the station to a trustee while retaining the economic risks and benefits of ownership. If the trustee is required to effect a sale of WALB-TV, the Company would incur a significant gain and related tax liability, the payment of which could have an adverse effect on the Company's ability to acquire comparable assets without incurring additional indebtedness. The FCC has allowed up to six months for the trustee to file an application seeking the agency's approval of a swap or sale. The approval process is expected to take between two and six months.

On May 4, 1998, Cosmos Broadcasting Corporation ("Cosmos"), a subsidiary of the Liberty Corporation signed a letter of intent to acquire WALB-TV, in a transaction valued at approximately $78.0 million. Under the proposed agreement, Cosmos will purchase a Wisconsin television station that the Company had intended to acquire and exchange it for WALB-TV in a like-kind exchange transaction. The station, WEAU-TV the NBC-affiliate operating on Channel 13 serving the Eau Claire-La Crosse market, is currently owned by Busse Broadcasting Corporation ("Busse"). On February 13, 1998, the Company signed a definitive purchase agreement to acquire all of the outstanding capital stock of Busse. The purchase price is approximately $112.0 million plus Busse's cash and cash equivalents less Busse's indebtedness including its 11 5/8 % Senior Secured Notes due 2000. Busse owns and operates three VHF television stations: KOLN-TV, the CBS-affiliate operating on Channel 10 in the Lincoln-Hastings-Kearney, Nebraska television market, and its satellite station KGIN-TV, the CBS-affiliate operating on Channel 11 serving Grand Island, Nebraska; and WEAU-TV. The exchange of WALB-TV for WEAU-TV and the purchase of Busse is subject to FCC approval. These transactions are expected to close on or before September 1, 1998. In connection with the proposed exchange of WALB-TV for WEAU-TV and the purchase of Busse, the Company will pay Bull Run Corporation, a principal stockholder of the Company, a finder's fee equal to 1% of the

LIQUIDITY AND CAPITAL RESOURCES (CONTINUED)

transaction values for services performed, none of which was due and included in accounts payable at March 31, 1998. If completed, the Company currently believes that funding for this acquisition could be provided primarily through cash flow from operations and borrowing under the Senior Credit Facility, although there can be no assurances that this acquisition would not require the sale by the Company of debt or equity securities.

The Company and its subsidiaries file a consolidated federal income tax return and such state or local tax returns as are required. As of March 31, 1998, the Company anticipates that it will generate taxable operating losses for the foreseeable 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.

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.

IMPACT OF YEAR 2000

Some of the Company's older computer programs were written using two digits rather than four to define the applicable year. As a result, those computer programs have time-sensitive software that recognize a date using "00" as the year 1900 rather than the year 2000. This could cause a system failure or miscalculations causing disruptions of operations, including, among other things, a temporary inability to process transactions, send invoices, or engage in similar normal business activities.

The Company has completed an assessment and will have to modify or replace portions of its software so that its computer systems will function properly with respect to dates in the year 2000 and thereafter. The Company does not believe that the estimated total Year 2000 project cost will have a material impact upon its financial position. Most of this cost will be realized over the estimated useful lives of the new hardware and software. To date, the Company has not incurred significant expenses associated with the Year 2000 issue.

The project is estimated to be completed no later than December 31, 1998, which is prior to any anticipated impact on its operating systems. The Company believes that with modifications to existing software and conversions to new software, the Year 2000 issue will not pose significant operational problems for its computer systems. However, if such modifications and conversions are not made, or are not completed timely, the Year 2000 issue could have a material impact on the operations of the Company.

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.

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: May 14, 1998

By: /s/ Frederick J. Erickson

Frederick J. Erickson,
interim Chief Financial Officer

This schedule contains summary financial information extracted from the March 31, 1998 unaudited condensed consolidated financial statements of Gray Communications Systems, Inc. and is qualified in its entirety by reference to such financial statements.

1
U.S. Dollars

3-MOS
DEC-31-1998
JAN-01-1998
MAR-31-1998
1
1,051,009
0
19,583,309
1,295,000
1,137,514
26,341,178
66,873,716
24,201,474
342,334,938
23,021,433
220,915,482
0
20,600,000
66,391,990
4,517,915
342,334,938
27,981,865
27,981,865
0
23,113,561
241,067
116,613
5,927,481
(1,300,244)
182,563
(1,482,807)
0
0
0
(1,841,805)
(0.23)
(0.23)