

الاتصالات السعودية
SAUDI TELECOM



a Saudi Joint Stock Company

**Interim Financial Statements for the
Fourth Quarter 2006**

**Interim Financial Statements for the
Three and Twelve Month Periods Ended December 31,
2006 (Unaudited)**

Saudi Telecom Company
(a Saudi Joint Stock Company)
Index to the Interim Financial Statements for the Three and Twelve Month Periods
Ended December 31, 2006 (Unaudited)

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REVIEW REPORT

To the shareholders
Saudi Telecom Company
(A Saudi Joint Stock Company)
Riyadh, Saudi Arabia

We have reviewed the accompanying interim balance sheet of Saudi Telecom Company (a Saudi Joint Stock Company) as of December 31, 2006 and the related interim statements of income for the three month and twelve month periods ended December 31, 2006 and the interim statement of cash flows for the twelve month period then ended. These interim financial statements are the responsibility of the Company's management and were presented to us with all the information and explanations which we requested.

Our review was a limited review in accordance with the standard of review of interim financial statements issued by the Saudi Organization for Certified Public Accountants. A review consists principally of applying analytical procedures to financial data and making inquiries of persons responsible for financial and accounting matters. Such limited review is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

As discussed in Note 27 to the financial statements, the Company did not disclose in its financial statements the segmental information, as required by generally accepted accounting standards in the Kingdom of Saudi Arabia.


Based on our review, except for non-disclosure of the segmental information referred to in the preceding paragraph, we are not aware of any material modifications that should be made to the accompanying interim financial statements for them to be in conformity with generally accepted accounting standards.

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Muharram 4, 1428
January 23, 2007

Saudi Telecom Company
(a Saudi Joint Stock Company)
Interim Balance Sheet as of December 31, 2006 (Unaudited)

| | <u>Notes</u> | <u>2006</u> <u>SR'000</u> | <u>2005</u> <u>SR'000</u> |
|----------------------------------------------------|--------------|------------------------------|------------------------------|
| <u>ASSETS</u> | | | |
| Current assets: | | | |
| Cash and cash equivalents | 3 | 2,909,321 | 4,004,821 |
| Short-term investments | 4 | 5,599,000 | 3,695,000 |
| Accounts receivable, net | 5 | 3,938,639 | 3,623,634 |
| Inventories, net | 6 | 149,700 | 153,288 |
| Prepayments and other current assets | 7 | <u>765,622</u> | <u>473,401</u> |
| Total current assets | | <u>13,362,282</u> | <u>11,950,144</u> |
| Non-current assets: | | | |
| Property, plant and equipment, net | 8 | 30,128,383 | 30,532,590 |
| Intangible assets, net | 9 | 731,766 | 753,750 |
| Investments accounted for under the equity method | 10 | 990,126 | 892,004 |
| Other investments | 11 | 150,033 | 100,033 |
| Other non-current assets | 12 | <u>759,183</u> | <u>515,355</u> |
| Total non-current assets | | <u>32,759,491</u> | <u>32,793,732</u> |
| Total assets | | <u>46,121,773</u> | <u>44,743,876</u> |
| <u>LIABILITIES AND SHAREHOLDERS' EQUITY</u> | | | |
| Current liabilities: | | | |
| Accounts payable | 13 | 1,959,937 | 2,605,975 |
| Dividends payable | 14 | 65,006 | 207,249 |
| Other payables | 15 | 2,355,215 | 2,135,496 |
| Accrued expenses | 16 | 3,749,277 | 3,176,734 |
| Deferred revenue - current | | <u>1,394,028</u> | <u>1,329,277</u> |
| Total current liabilities | | <u>9,523,463</u> | <u>9,454,731</u> |
| Non-current liabilities: | | | |
| Deferred revenue | | 623,569 | 821,168 |
| Employees' end of service benefits | 17 | <u>1,820,402</u> | <u>1,612,540</u> |
| Total non-current liabilities | | <u>2,443,971</u> | <u>2,433,708</u> |
| Total liabilities | | <u>11,967,434</u> | <u>11,888,439</u> |
| Shareholders' equity: | | | |
| Authorized, issued and outstanding shares | 18 | 20,000,000 | 15,000,000 |
| Statutory reserve | 19 | 5,818,458 | 4,538,568 |
| Retained earnings | | 8,339,223 | 13,320,211 |
| Unrealized loss on other investments | | <u>(3,342)</u> | <u>(3,342)</u> |
| Total shareholders' equity | | <u>34,154,339</u> | <u>32,855,437</u> |
| Total liabilities and shareholders' equity | | <u>46,121,773</u> | <u>44,743,876</u> |

The accompanying notes from 1 to 32 form an integral part of these interim financial statements.

Saudi Telecom Company
(a Saudi Joint Stock Company)
Interim Statement of Income for the Three and Twelve Month Periods Ended December
31, 2006 (Unaudited)
(Saudi Riyals in thousands)

| | <u>Notes</u> | <u>Three Months ended</u> <u>December 31,</u> | | <u>Twelve Months ended</u> <u>December 31,</u> | |
|--------------------------------------------------------------------|--------------|--------------------------------------------------|--------------------|---------------------------------------------------|---------------------|
| | | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| Operating Revenues | | | | | |
| Wireless | | 5,835,371 | 6,118,947 | 24,023,115 | 23,514,231 |
| Wire line | | <u>2,404,643</u> | <u>2,359,401</u> | <u>9,762,774</u> | <u>9,025,712</u> |
| Total operating revenues | 20 | <u>8,240,014</u> | <u>8,478,348</u> | <u>33,785,889</u> | <u>32,539,943</u> |
| Operating Expenses | | | | | |
| Government charges | 21 | (1,103,266) | (1,357,253) | (4,446,169) | (5,175,322) |
| Access charges | | (1,221,831) | (681,859) | (4,325,210) | (2,519,941) |
| Employee costs | 22 | (1,044,282) | (959,144) | (4,206,494) | (3,883,083) |
| Depreciation and amortization | 8, 9 | (1,045,977) | (899,003) | (3,835,792) | (3,836,211) |
| Administrative and marketing expenses | 23 | (881,322) | (708,930) | (2,886,446) | (2,140,781) |
| Repairs and maintenance | | <u>(369,891)</u> | <u>(460,668)</u> | <u>(1,437,633)</u> | <u>(1,622,552)</u> |
| Total operating expenses | | <u>(5,666,569)</u> | <u>(5,066,857)</u> | <u>(21,137,744)</u> | <u>(19,177,890)</u> |
| Operating Income | | <u>2,573,445</u> | <u>3,411,491</u> | <u>12,648,145</u> | <u>13,362,053</u> |
| Other Income and Expenses | | | | | |
| Cost of manpower improvement program | | (125,000) | (55,699) | (500,000) | (519,903) |
| Commissions | 3, 4, 11 | 100,823 | 73,630 | 416,613 | 207,274 |
| Earnings from investments accounted for under the equity method | 10 | 14,221 | 48,377 | 101,631 | 106,680 |
| Other, net | 24 | <u>298,832</u> | <u>(125,029)</u> | <u>475,089</u> | <u>(416,994)</u> |
| Other income and expenses, net | | <u>288,876</u> | <u>(58,721)</u> | <u>493,333</u> | <u>(622,943)</u> |
| Net Income before Zakat | | 2,862,321 | 3,352,770 | 13,141,478 | 12,739,110 |
| Provision for Zakat | | <u>(75,934)</u> | <u>(81,993)</u> | <u>(342,576)</u> | <u>(292,249)</u> |
| Net Income | | <u>2,786,387</u> | <u>3,270,777</u> | <u>12,798,902</u> | <u>12,446,861</u> |
| Basic earnings per share in Saudi Riyals | 18 | <u>1.39</u> | <u>1.64</u> | <u>6.40</u> | <u>6.22</u> |

The accompanying notes from 1 to 32 form an integral part of these interim financial statements.

Saudi Telecom Company
(a Saudi Joint Stock Company)
Interim Statement of Cash Flows for the Twelve Month Period Ended December 31, 2006
(Unaudited)
(Saudi Riyals in thousands)

| | <u>2006</u> | <u>2005</u> |
|-----------------------------------------------------------------------------------|---------------------|---------------------|
| CASH FLOWS FROM OPERATING ACTIVITIES | | |
| Net income | 12,798,902 | 12,446,861 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 3,835,792 | 3,836,211 |
| Doubtful debts expense | 435,602 | 272,393 |
| Earnings from investments accounted for under the equity method | (101,631) | (106,680) |
| Provision for capital work in progress | (24,057) | 389,251 |
| (Gains)/ losses on sale/ disposal of property, plant and equipment | (12,600) | 79,715 |
| Losses/ (Gains) on sale of other investments | 2,450 | (50,304) |
| Capitalized commission write-off | - | 304,184 |
| Changes in: | | |
| Accounts receivable | (750,607) | (762,465) |
| Inventories | 3,588 | 64,362 |
| Prepayments and other current assets | (292,221) | (276,850) |
| Other non-current assets | (243,828) | (433,338) |
| Accounts payable | (646,038) | (122,626) |
| Other payables | 219,719 | (508,766) |
| Accrued expenses | 572,543 | 1,361,945 |
| Deferred revenue | (132,848) | (179,966) |
| Employees' end of service benefits | <u>207,862</u> | <u>(30,870)</u> |
| Net cash provided by operating activities | <u>15,872,628</u> | <u>16,283,057</u> |
| CASH FLOWS FROM INVESTING ACTIVITIES | | |
| Capital expenditures | (3,392,713) | (4,389,144) |
| Short-term investments | (1,904,000) | (1,960,000) |
| Investment in Sabic's Sukuk | (150,000) | - |
| Proceeds from sale of other investments | 97,550 | 105,953 |
| Dividends received from investments accounted for under the equity method | 18,209 | 16,694 |
| Investment in Tejari Saudi Arabia | (14,700) | - |
| Proceeds from sale of property, plant and equipment | 19,769 | 28,835 |
| Intangible assets | - | <u>(753,750)</u> |
| Net cash used in investing activities | <u>(5,325,885)</u> | <u>(6,951,412)</u> |
| CASH FLOWS FROM FINANCING ACTIVITIES | | |
| Dividends paid | <u>(11,642,243)</u> | <u>(10,340,529)</u> |
| Net cash used in financing activities | <u>(11,642,243)</u> | <u>(10,340,529)</u> |
| NET DECREASE IN CASH AND CASH EQUIVALENTS | (1,095,500) | (1,008,884) |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD | 4,004,821 | 5,013,705 |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD | <u>2,909,321</u> | <u>4,004,821</u> |

The accompanying notes from 1 to 32 form an integral part of these interim financial statements.

Saudi Telecom Company
(a Saudi Joint Stock Company)
Notes to the Interim Financial Statements for the Three and Twelve Month Periods
Ended December 31, 2006 (Unaudited)

1 GENERAL

Saudi Telecom Company (the "Company") was established as a Saudi Joint Stock Company pursuant to Royal Decree No. M/35, dated 24 Dhul Hijja 1418 H (April 21, 1998) which authorized the transfer of the telegraph and telephone division of the Ministry of Post, Telegraph and Telephone ("MoPTT") (hereinafter referred to as "Telecom Division") with its various components and technical and administrative facilities to the Company, and in accordance with the Council of Ministers' Resolution No. 213 dated 23 Dhul Hijja 1418 H (April 20, 1998) which approved the Company's Articles of Association (the "Articles"). The Company was wholly owned by the Government of the Kingdom of Saudi Arabia (the "Government"). Pursuant to the Council of Ministers' Resolution No. 171 dated 2 Rajab 1423 H (September 9, 2002), the Government sold 30% of its shares.

The Company commenced its operations as the provider of telecommunications services throughout the Kingdom of Saudi Arabia (the "Kingdom") on 6 Muharram 1419 H (May 2, 1998), and received its Commercial Registration No. 101050269 as a Saudi Joint Stock Company on 4 Rabi Awal 1419 H (June 29, 1998). The Company's head office is located in Riyadh.

The Company provides a range of telecommunications services which includes mobile, fixed local, national and international telephone services, telex, telegraph, data transmission, leased lines, public telephones, public network and radio paging services.

The Company is the dominant telecommunications services provider within, to and from the Kingdom. In accordance with the Council of Ministers' Resolution No. 171, referred-to above, it was approved that the telecommunications sector be opened for competition by partially liberalizing the mobile and fixed line services. A new GSM operator started its operations in May 2005. During 2003, the Communications and Information Technology Commission ("CITC") issued licenses for Very Small Aperture Terminals (V-SAT), and also issued licenses, during 2004, for the provision of data services.

2 SIGNIFICANT ACCOUNTING POLICIES

The accompanying interim financial statements are prepared in accordance with accounting standards generally accepted in the Kingdom. The significant accounting policies are summarized below:

a) Period of the financial statements

According to the Company's Articles, the Company's financial year begins on January 1 and ends on December 31 of the same year.

The interim financial statements are prepared on the basis of integrated periods, which views each interim period as an integral part of the financial year. Accordingly, revenues, gains, expenses and losses of the period are recognized during the period.

b) Interim results

The results of operations for the interim period may not represent a proper indication of the annual results of operations.

c) Revenue recognition

Revenue is recognized when services are rendered based on the access to, or usage of, the exchange network and facilities. Usage revenues are based upon fractions of traffic minutes processed, applying rates approved by the CITC.

- Charges billed in advance are deferred and recognized over the period in which the services are rendered.
- Unbilled revenue is recognized in the period to which it relates.

Saudi Telecom Company
(a Saudi Joint Stock Company)

Notes to the Interim Financial Statements for the Three and Twelve Month Periods
Ended December 31, 2006 (Unaudited)

- Revenue is recognized upon collection when collectability is highly uncertain.
- Non-refundable up-front activation fees received from customers up to the end of the first quarter 2006 were deferred and recognized over the estimated service lives for the customers. Non-refundable up-front activation fees are recognized upon receipt, starting from the second quarter 2006.
- Wireless revenues are composed mainly of mobile, international and national roaming services, while wireline revenues are composed mainly of fixed lines, international settlements, leased circuits, data and internet services.

d) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances with banks and all highly liquid investments with maturity of 90 days or less from the acquisition date. Cash and cash equivalents are stated at cost.

e) Accounts receivable

Accounts receivable are shown at their net realizable values, which represent billings and unbilled usage revenues net of allowances for doubtful debts.

f) Allowance for doubtful debts

The Company reviews its accounts receivable for the purpose of creating the required allowances against doubtful debts. When creating the allowance, consideration is given to the type of service rendered (mobile, land line, telex, international settlements...etc), age of the receivable, the Company's previous experience in debt collection and the general economic situation.

g) Inventories

- Inventories, which are principally cables, spare parts and consumables, are stated at weighted average cost, net of allowances. Inventory items that are considered an integral part of the network assets, such as emergency spares which cannot be removed from the exchange, are recorded within property, plant and equipment. Inventory items held by contractors responsible for upgrading and expanding the network are recorded within 'capital work-in-progress'.
- The Company creates an allowance for obsolete and slow-moving inventories, based on a study of the movement of the major inventory categories. When such an exercise is impractical, the allowance is based on groups or categories of inventory items, taking into consideration the items which may require significant reductions in their values.

h) Property, plant and equipment and depreciation

1. Prior to May 2, 1998, the Telecom Division did not maintain sufficiently detailed historical information to record property, plant and equipment based on historical cost. Consequently all property, plant and equipment transferred by the Telecom Division on May 2, 1998 has been recorded based on a valuation performed by the Company with the assistance of independent international and local valuation experts. The principal bases used for valuation are as follows:

| | |
|----------------------------------|------------------------------|
| - Land | Appraised value |
| - Buildings, plant and equipment | Depreciated replacement cost |

2. Other than what is mentioned in (1) above, property, plant and equipment acquired by the Company are recorded at historical cost.

Saudi Telecom Company
(a Saudi Joint Stock Company)

Notes to the Interim Financial Statements for the Three and Twelve Month Periods
Ended December 31, 2006 (Unaudited)

3. Cost of the network comprises all expenditures up to the customer connection point, including contractors' charges, direct materials and labor costs up to the date the relevant assets are placed in service.
4. Property, plant and equipment, excluding land, are depreciated on a straight line basis over the following estimated useful lives:

| | <u>Years</u> |
|----------------------------------------|--------------|
| Buildings | 22 – 30 |
| Telecommunications plant and equipment | 5 – 25 |
| Other assets | 5 |

5. Repairs and maintenance costs are expensed as incurred, except to the extent that they increase productivity or extend the useful life of an asset, in which case they are capitalized.
6. The Company reviews periodically its property, plant and equipment to determine whether any of the assets are permanently impaired, whenever events or changes in circumstances indicate that. The amount of impairment is included in the interim statement of income in the period when such determination is made, and property, plant and equipment is reported net.
7. Gains and losses resulting from the disposal/ sale of property, plant and equipment are determined by comparing the proceeds with the book values of disposed-off / sold assets, and the gains or losses are included in the interim statement of income.

i) Intangible assets

Intangible assets are recorded upon acquisition at cost, and are amortized starting from the date of service provisioning on a straight line basis over their useful lives or statutory durations, whichever is shorter. The 3G mobile licence fees are being amortized over twenty years. The Company reviews periodically the intangible assets, on periodical basis, to determine whether they are permanently impaired, whenever events or changes in circumstances indicate that. The amount of impairment, if any, is included in the interim statement of income in the period when such determination is made.

j) Software costs

- Costs of operating systems and application software purchased from vendors are capitalized if they meet the capitalization criteria, which include productivity enhancement or a noticeable increase in the useful life of the asset. These costs are amortized over the estimated period of the provided benefits.
- Internally developed operating systems software costs are capitalized if they meet the capitalization criteria, which include the dedication of a defined internal work group to develop the software and the ability to readily identify related costs. These costs are amortized over the estimated period of the provided benefits.
- Internally developed application software costs are recognized as expense when incurred. Where the costs of operating systems software cannot be identified separately from the associated hardware costs, the operating systems software costs are recorded as part of the hardware.
- Subsequent additions, modifications or upgrades of software programs, whether operating or application packages, are expensed as incurred.
- Software training and data-conversion costs are expensed as incurred.

Saudi Telecom Company
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Notes to the Interim Financial Statements for the Three and Twelve Month Periods
Ended December 31, 2006 (Unaudited)

k) Investments accounted for under the equity method

The Company accounts for investments in entities in which it has a significant influence under the equity method. Under the equity method, the Company records the investment on acquisition at cost, which is adjusted subsequently by the Company's share in the net income (loss) of the investee, the investee's distributed dividends and any changes in the investee's equity, to reflect the Company's share in the investee's net assets. These investments are reflected in the interim balance sheet as non-current assets, and the Company's share in the net income (loss) of the investee is presented in the interim statement of income.

l) Other investments

- Available for sale marketable securities are carried at fair value, which is based on market value when available. However, if fair value cannot be determined, due to non-availability of an active exchange market or other indexes through which market value can reasonably be determined, cost will be considered as the alternative fair value. Unrealized gains and losses are shown as a separate component within the shareholders' equity in the interim balance sheet. Losses resulting from permanent declines in fair values below costs are recorded in the interim statement of income in the period in which the declines occur.
- Investments held to maturity are recorded at cost and adjusted for amortization of premiums and accretion of discounts, if any. Losses resulting from permanent declines in fair values below costs are recorded in the interim statement of income in the period in which the declines occur.
- Gains and losses resulting from sales of available for sale securities are recorded in the period of sale, and previously recorded unrealized gains and losses are reversed.

m) Zakat

The Company calculates and reports the zakat provision in its financial statements in accordance with Zakat rules and principles, and the instructions of the Department of Zakat and Income Taxes. Adjustments arising from final zakat assessments are recorded in the period in which such assessments are approved.

n) Employees' end of service benefits

The provision for employees' end of service benefits represents amounts due and payable to the employees upon the termination of their contracts, in accordance with the terms and conditions of the Saudi Labor and Workman Law. The provision is calculated on the basis of vested benefits to which the employees are entitled should they leave at the date of the interim balance sheet, using the employees' latest salaries and allowances and years of service in the Company.

o) Foreign currency transactions

- The Company maintains its financial records in Saudi Riyals and records foreign currency transactions at the appropriate rate of exchange prevailing at the date of the transaction.
- Balances of monetary assets and liabilities denominated in foreign currencies of specific amounts are translated using rates of exchange prevailing at the interim balance sheet date.
- Gains and losses arising on the settlement of foreign currency transactions, and unrealized gains and losses resulting from the translation to Saudi Riyals of foreign currency denominated monetary balances are recorded in the interim statement of income.

Saudi Telecom Company
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Ended December 31, 2006 (Unaudited)

p) Government charges

Government charges are the costs incurred for the right to operate the telecommunications services in the Kingdom, including use of the frequency spectrum. Government charges are accrued in the relevant periods.

q) Access charges

Access charges represent the costs to connect to foreign and domestic carriers' networks for calls made by the Company's customers. Access charges are recognized in the periods of relevant calls.

r) Administrative and marketing expenses

Administrative and marketing expenses are expensed as incurred when it is not possible to determine the relevant benefiting periods. Otherwise, they will be charged to the relevant periods.

s) Earnings per share

Earnings per share are calculated by dividing net income for the financial period by the weighted average number of shares outstanding during the period.

3 CASH AND CASH EQUIVALENTS

A part of surplus cash is invested in Murabaha deals with maturity periods of 90 days or less with several local banks. The average rate of commission on these deals during the fourth quarter 2006 was 4.3% (fourth quarter 2005: 5.2%). Total commission earned on these deals during the fourth quarter 2006 was SR 44.8 million (fourth quarter 2005: SR 32.1 million).

Cash and cash equivalents at the end of the year include balances of collection accounts at various local banks. As per agreements with the banks, funds are to be transferred to the Company's main account on the fourth day of the subsequent month.

At the end of the period, cash and cash equivalents consisted of the following:

| (Thousands of Saudi Riyals) | <u>2006</u> | <u>2005</u> |
|-----------------------------|------------------|------------------|
| Collection accounts | 2,444,490 | 2,492,295 |
| Short-term Murabaha deals | 302,505 | 1,256,500 |
| Disbursement accounts | <u>162,326</u> | <u>256,026</u> |
| | <u>2,909,321</u> | <u>4,004,821</u> |

4 SHORT-TERM INVESTMENTS

A portion of the surplus cash is invested in Murabaha deals with maturity periods of more than 90 days. The average rate of commission on these deals during the fourth quarter 2006 was 5.1% (fourth quarter 2005: 5.6%). Total commission earned on these deals during the fourth quarter 2006 was SR 53.8 million (fourth quarter 2005: SR 37.7 million).

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Notes to the Interim Financial Statements for the Three and Twelve Month Periods
Ended December 31, 2006 (Unaudited)

5 ACCOUNTS RECEIVABLE, NET

(a) Accounts receivable consisted of the following:

| (Thousands of Saudi Riyals) | <u>2006</u> | <u>2005</u> |
|------------------------------|------------------|------------------|
| Billed receivables | 3,143,447 | 2,378,959 |
| Unbilled receivables | <u>1,370,632</u> | <u>1,788,585</u> |
| | 4,514,079 | 4,167,544 |
| Allowance for doubtful debts | <u>(575,440)</u> | <u>(543,910)</u> |
| | <u>3,938,639</u> | <u>3,623,634</u> |

Movement in the allowance for doubtful debts during the period was as follows:

| (Thousands of Saudi Riyals) | <u>2006</u> | <u>2005</u> |
|-----------------------------|------------------|------------------|
| Balance at January 1 | 543,910 | 877,967 |
| Additions (Note 23) | <u>435,602</u> | <u>272,393</u> |
| | 979,512 | 1,150,360 |
| Bad debts written-off | <u>(404,072)</u> | <u>(606,450)</u> |
| Balance at December 31 | <u>575,440</u> | <u>543,910</u> |

(b) Since inception, the Company recognizes revenues from services rendered to particular customers upon collection where collectability is highly uncertain. The Company is currently pursuing the collection of these revenues. Uncollected revenues from such customers for the fourth quarter 2006 amounted to SR 23 million (fourth quarter 2005: SR 40 million), with an annual average of SR 220 million for the seven years preceding 2006.

(c) The Company has agreements with foreign network operators whereby amounts receivable from and payable to the same foreign network operator are subject to offsetting. At December 31, 2006 and 2005, the net amounts included in accounts receivable and accounts payable were as follows:

| (Thousands of Saudi Riyals) | <u>2006</u> | <u>2005</u> |
|----------------------------------------|----------------|----------------|
| International accounts receivable, net | <u>347,006</u> | <u>484,033</u> |
| International accounts payable, net | <u>862,191</u> | <u>755,530</u> |

(d) In accordance with paragraph (7) of the Council of Ministers' Resolution No. 171 referred to in Note (1), the Company settles the amounts due to the Government as government charges against accumulated receivable balances due from Government for usage of the Company's telecom services.

6 INVENTORIES, NET

Movement in inventories during the period was as follows:

| (Thousands of Saudi Riyals) | <u>2006</u> | <u>2005</u> |
|-----------------------------|------------------|------------------|
| Balance at January 1 | 163,744 | 230,473 |
| Additions | 123,633 | 323,512 |
| Usage | <u>(128,414)</u> | <u>(390,241)</u> |
| | 158,963 | 163,744 |
| Inventory allowance | <u>(9,263)</u> | <u>(10,456)</u> |
| Balance at December 31 | <u>149,700</u> | <u>153,288</u> |

Saudi Telecom Company
(a Saudi Joint Stock Company)
Notes to the Interim Financial Statements for the Three and Twelve Month Periods
Ended December 31, 2006 (Unaudited)

7 PREPAYMENTS AND OTHER CURRENT ASSETS

Prepayments and other current assets consisted of the following:

| (Thousands of Saudi Riyals) | <u>2006</u> | <u>2005</u> |
|---------------------------------------------------|----------------|----------------|
| Frequency evacuation project | 272,906 | 191,671 |
| Accrued commissions and receivables | 169,048 | 47,076 |
| Advances to suppliers | 126,150 | 65,164 |
| Deferred costs | 66,556 | 59,871 |
| Prepaid rent | 56,019 | 53,400 |
| Employee housing loans-Current (Refer to Note 12) | 51,498 | 31,728 |
| Prepaid insurance | 19,484 | 20,229 |
| Other | <u>3,961</u> | <u>4,262</u> |
| | <u>765,622</u> | <u>473,401</u> |

The frequency evacuation project, which is agreed upon with official parties, is to evacuate the frequencies used for the benefit of the CITC and to build an alternative network by the Company. The project costs of SR 250 million have been deducted from the balance payable to the Government and reflected under "Other payables", however, the remaining amount will be settled at the end of the project. (Refer to Note 15).

8 PROPERTY, PLANT AND EQUIPMENT, NET

| (Thousands of Saudi Riyals) | <u>Land and Buildings</u> | <u>Telecommunications Plant and Equipment</u> | <u>Other Assets</u> | <u>Capital Work In Progress</u> | <u>2006</u> | <u>2005</u> |
|----------------------------------------|---------------------------|-----------------------------------------------|---------------------|---------------------------------|-------------------|--------------------|
| Gross book value | | | | | | |
| At January 1 | 9,481,873 | 45,249,291 | 1,089,531 | 3,543,032 | 59,363,727 | 57,168,129 |
| Additions | 962 | 111,813 | 117,534 | 3,162,404 | 3,392,713 | 4,389,144 |
| Transfers | 391,776 | 2,528,705 | 5 | (2,920,486) | - | - |
| Disposals | <u>-</u> | <u>(151,677)</u> | <u>(70,989)</u> | <u>(365,194)</u> | <u>(587,860)</u> | <u>(2,193,546)</u> |
| At December 31 | <u>9,874,611</u> | <u>47,738,132</u> | <u>1,136,081</u> | <u>3,419,756</u> | <u>62,168,580</u> | <u>59,363,727</u> |
| Accumulated depreciation | | | | | | |
| At January 1 | 3,890,272 | 23,726,775 | 824,839 | 389,251 | 28,831,137 | 26,386,487 |
| Charge | 270,566 | 3,435,861 | 107,381 | - | 3,813,808 | 3,836,211 |
| Provision for capital work in progress | - | - | - | (389,251) | (389,251) | 389,251 |
| Disposals | <u>-</u> | <u>(144,895)</u> | <u>(70,602)</u> | <u>-</u> | <u>(215,497)</u> | <u>(1,780,812)</u> |
| At December 31 | <u>4,160,838</u> | <u>27,017,741</u> | <u>861,618</u> | <u>-</u> | <u>32,040,197</u> | <u>28,831,137</u> |
| Net book value | <u>5,713,773</u> | <u>20,720,391</u> | <u>274,463</u> | <u>3,419,756</u> | <u>30,128,383</u> | <u>30,532,590</u> |

(a) Land and buildings above include land of SR 2,299 million as of December 31, 2006 and 2005.

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- (b) In accordance with the Royal Decree referred to in Note (1), the ownership of assets had been transferred to the Company as of May 2, 1998. However, the transfer of legal ownership of certain land parcels is still in progress. Land parcels for which legal ownership has been transferred into the Company' name amounted to SR 1,615 million as of December 31, 2006. The transfer of the ownership of the remaining land parcels with a value of SR 684 million is still in progress.
- (c) During the year 2005, the Company reviewed its property, plant and equipment and capital work in progress, and as a result capitalized commission amounting to SR 304 million was written-off, and a provision of SR 389 million was created against capital work in progress. The provision has been cleared in the third quarter 2006.

9 INTANGIBLE ASSETS, NET

On 27 Jumada Awal 1426H (July 4, 2005), the CITC granted the Company license to provide the Third Generation (3G) mobile services. The commercial provisioning of this service commenced in June 2006.

Intangible assets consist of the following as of December 31:

| (Thousands of Saudi Riyals) | <u>2006</u> | <u>2005</u> |
|--------------------------------------------------------|-----------------|----------------|
| License for the Third Generation (3G) mobile services: | | |
| Cost | 753,750 | 753,750 |
| Amortization during the period | <u>(21,984)</u> | <u>-</u> |
| Net book value at December 31 | <u>731,766</u> | <u>753,750</u> |

10 INVESTMENTS ACCOUNTED FOR UNDER THE EQUITY METHOD

Investments accounted for under the equity method of accounting consist of the following:

| (Thousands of Saudi Riyals) | <u>2006</u> | | <u>2005</u> | |
|--------------------------------------------------------|------------------|----------------|------------------|----------------|
| | <u>Ownership</u> | | <u>Ownership</u> | |
| Arab Satellite Communications Organization ("Arabsat") | 36.66% | 925,647 | 36.66% | 846,633 |
| Arab Submarine Cables Company Ltd. | 44.29% | 49,779 | 42.86% | 45,371 |
| Tejari Saudi Arabia | 50.00% | <u>14,700</u> | | <u>-</u> |
| | | <u>990,126</u> | | <u>892,004</u> |

Arabsat

This organization was established in April 1976 by member states of the Arab League. Arabsat offers a number of services to member states, as well as to all public and private sectors within its coverage area, principally the Middle East.

Current services offered include regional telephony (voice, data, fax and telex), television broadcasting, regional radio broadcasting, restoration services and leasing of capacity on an annual or monthly basis.

Arab Submarine Cables Company Ltd.

Arab Submarine Cables Company Ltd. Was established in September 2002 for the purpose of constructing, leasing, managing and operating a submarine cable connecting the Kingdom and the

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Republic of Sudan for telecommunications between them and any other countries. The operations of the Arab Submarine Cables Company Ltd. started effective June 2003.

Tejari Saudi Arabia

Tejari Saudi Arabia (a limited liability company) was formed in November 2006 for the purpose of establishment, operation and management of electronic markets and platforms, and to provide all services related to e-commerce dealings. The company did not commence the commercial activities as of December 31, 2006.

11 OTHER INVESTMENTS

(a) Other investments consist of the following:

| (Thousands of Saudi Riyals) | <u>2006</u> | <u>2005</u> |
|---------------------------------------|----------------|----------------|
| Held to maturity: | | |
| Investment in Sabic's Sukuk | 150,000 | - |
| Notes | <u>-</u> | <u>100,000</u> |
| | <u>150,000</u> | <u>100,000</u> |
| Available for sale – at market value: | | |
| Investment in New ICO | <u>33</u> | <u>33</u> |
| Total other investments | <u>150,033</u> | <u>100,033</u> |

(b) The Sukuk were acquired from the Saudi Basic Industries Corporation "Sabic" in July 2006 for SR 150 million, with maturity of 5 years up to July 2011, and a commission rate equal to the Saudi Inter-Bank Offered Rate ("SIBOR") plus 0.40%. Commission earned from these Sukuk during the fourth quarter 2006 amounted to SR 2.2 million.

(c) Notes issued by a local bank were acquired at the end of 2004 for SR 100 million, with maturity period of seven years up to December 2011, callable after five years, bearing floating commission rates. The notes were sold during the second quarter 2006 and a loss on sale amounting to SR 2.45 million was realized. Commission earned from these notes during the fourth quarter 2005 amounted to SR 1.3 million.

(d) During the first quarter 2005, the Company sold its investment in Intelsat Ltd. for SR 105.9 million and realized a gain amounting to SR 50.3 million.

(e) The balance of unrealized losses on available for sale investment in New ICO reflected at market value amounted to SR 3.3 million at December 31, 2006 and 2005.

12 OTHER NON-CURRENT ASSETS

Other non-current assets consist of the following:

| (Thousands of Saudi Riyals) | <u>2006</u> | <u>2005</u> |
|-----------------------------|----------------|----------------|
| Employee housing loans | 703,687 | 441,362 |
| Deferred costs | <u>55,496</u> | <u>73,993</u> |
| | <u>759,183</u> | <u>515,355</u> |

During 2005, the Company started granting Employee housing loans, bearing no commission, in accordance with the approved policy. These loans are stated at cost as of December 31, 2006.

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13 ACCOUNTS PAYABLE

(a) Accounts payable consist of the following:

| (Thousands of Saudi Riyals) | <u>2006</u> | <u>2005</u> |
|-----------------------------|------------------|------------------|
| Government charges | 672,852 | 1,113,256 |
| International settlements | 862,191 | 755,530 |
| Trade | 386,811 | 548,260 |
| Capital expenditures | 38,083 | 188,929 |
| | <u>1,959,937</u> | <u>2,605,975</u> |

(b) The Company settled the amounts due to the Government in relation to the government charges against accumulated balances due from governmental entities. Certain international settlements accounts payable balances are netted against international settlements accounts receivable balances. (Refer to Note 5).

14 DIVIDENDS PAYABLE

Movement in dividends during the period was as follows:

| (Thousands of Saudi Riyals) | <u>2006</u> | <u>2005</u> |
|------------------------------------------------|---------------------|---------------------|
| Balance at January 1 | 207,249 | 47,778 |
| Dividends declared for the fourth quarter 2005 | 3,000,000 | - |
| Dividends declared for the first quarter 2006 | 2,500,000 | - |
| Dividends declared for the second quarter 2006 | 3,000,000 | - |
| Dividends declared for the third quarter 2006 | 3,000,000 | - |
| Dividends declared for the second half of 2004 | - | 4,200,000 |
| Dividends declared for the first half of 20 05 | - | 4,200,000 |
| Dividends declared for the third quarter 2005 | - | 2,100,000 |
| | <u>11,707,249</u> | <u>10,547,778</u> |
| Payments made during the period | <u>(11,642,243)</u> | <u>(10,340,529)</u> |
| Balance at December 31 | <u>65,006</u> | <u>207,249</u> |

15 OTHER PAYABLES

Other payables consist of the following:

| (Thousands of Saudi Riyals) | <u>2006</u> | <u>2005</u> |
|------------------------------------------------|------------------|------------------|
| Suppliers' retentions | 867,279 | 866,720 |
| Provision for Zakat | 296,799 | 284,325 |
| Settlement of seconded employees' entitlements | 282,052 | 338,635 |
| Withholding tax provision | 260,410 | 121,016 |
| Manpower improvement program | 252,005 | 47,428 |
| Frequency evacuation project (Refer to Note 7) | 250,000 | 250,000 |
| Refundable customers' guarantee deposits | 90,826 | 83,366 |
| Other | 55,844 | 144,006 |
| | <u>2,355,215</u> | <u>2,135,496</u> |

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In accordance with the Council of Ministers' Resolution No. 75 dated 5 Rabi Awal 1422 H (May 28, 2001), the Company recognized in the statement of income for 2001 an estimated amount which represented 50% of the total amount for the settlement of the MoPTT seconded employees' pension entitlements.

The Council of Ministers' Resolution No. 198 dated 18 Rajab 1424 H (September 15, 2003) approved the system of exchanging benefits between the Civil and Military Pension System and the Social Insurance System. The estimated amount has been reconciled based on the actual number of employees who choose to terminate their services or settle their pension entitlements, after the concerned parties made their final decision in regard to this issue.

16 ACCRUED EXPENSES

Accrued expenses consist of the following:

| (Thousands of Saudi Riyals) | <u>2006</u> | <u>2005</u> |
|-----------------------------|------------------|------------------|
| Capital expenditures | 1,583,649 | 1,963,930 |
| Trade | 1,029,007 | 202,418 |
| Employee accruals | 938,950 | 834,229 |
| Land provision | <u>197,671</u> | <u>176,157</u> |
| | <u>3,749,277</u> | <u>3,176,734</u> |

17 EMPLOYEES' END OF SERVICE BENEFITS

The movement in employees' end of service benefits during the period was as follows:

| (Thousands of Saudi Riyals) | <u>2006</u> | <u>2005</u> |
|-----------------------------|------------------|------------------|
| Balance at January 1 | 1,612,540 | 1,643,410 |
| Charges (Note 22) | 325,760 | 298,692 |
| Settlements | <u>(117,898)</u> | <u>(329,562)</u> |
| Balance at December 31 | <u>1,820,402</u> | <u>1,612,540</u> |

The provision is calculated on the basis of vested benefits to which the employees are entitled should they leave at the balance sheet date, using the employees' latest salaries and allowances and years of service in the Company.

18 SHARE CAPITAL

At December 31, 2006, the Company's capital amounts to SR 20,000 million, divided into 2,000 million fully paid shares at par value of SR 10 each. As of December 31, 2006 and 2005, the Government owned 70% of the Company's shares

At the beginning of year 2005 the capital was SR 15,000 million, divided into 300 million shares, at par value of SR 50 each.

In accordance with the Capital Market Authority's decision No. 4-154-2006 dated 27 Safar 1427 H (March 27, 2006), which was based on the Council of Ministers' resolution concerning the split of joint stock companies' shares on that date, the par value per share was split to become SR 10 instead of SR 50. As a result the number of the Company's shares became 1,500 million.

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The Company's General Assembly, in its extraordinary meeting of 13 Rabi Awal 1427 H (April 11, 2006), approved the increase of the Company's share capital from SR 15,000 million to SR 20,000 million through a stock dividend of one bonus share for each three outstanding shares with a total value of SR 5,000 million through a transfer from the retained earnings. Accordingly, the number of shares was increased to 2 billion shares.

Basic earnings per share were calculated for the 2005 comparatives to retrospectively reflect the effect of the shares increase and split which took place in 2006.

19 STATUTORY RESERVE

10% of annual net income is appropriated as statutory reserve until such reserve equals 50% of issued share capital. This reserve is not available for distribution to the Company's shareholders. During the fourth quarter 2006 the Company appropriated an amount of SR 278.6 million (fourth quarter 2005: SR327.1 million). The statutory reserve on December 31, 2006 amounted to SR 5,818 million, which represents 29% of share capital (December 31, 2005: SR4,539 million, which represents 23% of share capital).

20 OPERATING REVENUES

Operating revenues consist of the following:

| (Thousands of Saudi Riyals) | <u>Three Months ended</u> | | <u>Twelve Months ended</u> | |
|-----------------------------|---------------------------|------------------|----------------------------|-------------------|
| | <u>December 31,</u> | | <u>December 31,</u> | |
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| Usage charges | 6,458,125 | 6,762,780 | 26,790,008 | 25,835,087 |
| Subscription fees | 1,295,223 | 1,243,349 | 5,150,241 | 4,725,254 |
| Activation fees | 119,225 | 156,385 | 586,437 | 582,700 |
| Other | <u>367,441</u> | <u>315,834</u> | <u>1,259,203</u> | <u>1,396,902</u> |
| | <u>8,240,014</u> | <u>8,478,348</u> | <u>33,785,889</u> | <u>32,539,943</u> |

The Company entered into a Build-Operate-Transfer ("BOT") agreement with a local company to provide wireless communications based on the integrated Digital Enhanced Network (iDEN) platform, which has been named "Bravo". Service provision, which includes communications and digital cellular services, started in July 2005. Revenue from this service has been included in "Other".

Non-refundable up-front activation fees are recognized as revenue upon receipt starting from the second quarter 2006, and the change had no material effect on the financial results. Such fees currently approximate the actual cost of service activation.

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21 GOVERNMENT CHARGES

The Government charges the Company fees in exchange for granting the Company the right to operate and provide Kingdom-wide telecommunications services. These charges are based on net revenue. Net revenue is defined as total operating revenues less access charges as reflected in the statement of income. The Government charges were calculated as follows:

| (Thousands of Saudi Riyals) | <u>Three Months ended</u> | | <u>Twelve Months ended</u> | |
|---------------------------------|---------------------------|------------------|----------------------------|------------------|
| | <u>December 31,</u> | | <u>December 31,</u> | |
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| Commercial service provisioning | 970,930 | 1,191,652 | 3,993,517 | 4,540,696 |
| License fees | 66,916 | 79,443 | 284,903 | 302,713 |
| Frequency spectrum | <u>65,420</u> | <u>86,158</u> | <u>167,749</u> | <u>331,913</u> |
| | <u>1,103,266</u> | <u>1,357,253</u> | <u>4,446,169</u> | <u>5,175,322</u> |

The following illustrates the basis on which the Government charges are calculated:

(a) Commercial Service Provisioning

The fees for commercial provisioning of all services, except Data, are 15% of net revenue (as defined above). The fees for Data services are 8% of net revenue, applied effective the beginning of 2005, which resulted in a reduction in the fees recalculated by the Company during 2006.

(b) License Fees

License fees were determined as 1% of net revenue (as defined above).

(c) Frequency Spectrum

The fees for usage of the frequency spectrum are calculated in accordance with the pricing list issued by the CITC, the application date of which corresponds to 25 Dhul Quada 1425 H (January 6, 2005). The new method of calculating the fees depends on various factors, the most important of which being the locations and widths of required frequencies, distances covered and technologies applied. The Company reviewed the frequency tables in order to specify its actual requirements and, accordingly, determine the ultimate cost, which resulted in a reduction in the fees recalculated by the Company during 2006. The Company agreed to settle most of the accrued amount. However, the final frequencies table is being worked upon with the CITC,

(d) The Government charges were reduced by SR 97.9 million, being an accrued receivable related to government charges paid by the Company on behalf of the new mobile operator (Mobily) in 2006.

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22 EMPLOYEE COSTS

Employee costs consist of the following:

| (Thousands of Saudi Riyals) | <u>Three Months ended</u> | | <u>Twelve Months ended</u> | |
|-----------------------------|---------------------------|----------------|----------------------------|------------------|
| | <u>December 31,</u> | | <u>December 31,</u> | |
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| Salaries and allowances | 737,467 | 724,255 | 2,964,289 | 2,819,381 |
| Incentives and rewards | 82,789 | 65,159 | 397,316 | 279,201 |
| End of service benefits | 66,941 | 60,315 | 325,760 | 298,692 |
| Social insurance | 64,050 | 59,668 | 256,469 | 234,608 |
| Medical insurance | 44,737 | 37,229 | 153,415 | 150,376 |
| Vacations | 31,711 | (1,264) | 50,855 | 38,158 |
| Other | <u>16,587</u> | <u>13,782</u> | <u>58,390</u> | <u>62,667</u> |
| | <u>1,044,282</u> | <u>959,144</u> | <u>4,206,494</u> | <u>3,883,083</u> |

23 ADMINISTRATIVE AND MARKETING EXPENSES

Administrative and marketing expenses consist of the following:

| (Thousands of Saudi Riyals) | <u>Three Months ended</u> | | <u>Twelve Months ended</u> | |
|------------------------------------------------|---------------------------|----------------|----------------------------|------------------|
| | <u>December 31,</u> | | <u>December 31,</u> | |
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| Sales commissions and advertising expenses | 404,246 | 262,570 | 1,288,090 | 835,603 |
| Doubtful debts expense (Note 5) | 165,006 | 134,616 | 435,602 | 272,393 |
| Printing of telephone cards and stationery | 68,298 | 79,406 | 245,637 | 199,302 |
| Consultancy | 62,800 | 31,914 | 199,898 | 111,388 |
| Rent of equipment, property and motor vehicles | 37,666 | 29,538 | 137,890 | 116,787 |
| Utilities | 28,792 | 43,177 | 151,607 | 167,901 |
| Training | 22,220 | 21,832 | 77,264 | 87,296 |
| Telecommunications, courier and delivery | 22,184 | 61,519 | 104,414 | 144,579 |
| Safety expenses | 20,349 | 19,758 | 79,827 | 78,334 |
| Other | <u>49,761</u> | <u>24,600</u> | <u>166,217</u> | <u>127,198</u> |
| | <u>881,322</u> | <u>708,930</u> | <u>2,886,446</u> | <u>2,140,781</u> |

During the third quarter 2005, the Company made a study of the allowance for doubtful debts, based on additional information provided by the billing system. The study resulted in amending some elements of the allowance calculation and the basis for determining its appropriate level.

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24 OTHER INCOME AND EXPENSES, NET

Other income and expenses consist of the following:

| (Thousands of Saudi Riyals) | <u>Three Months ended</u> | | <u>Twelve Months ended</u> | |
|-----------------------------------------------------------------------|---------------------------|------------------|----------------------------|------------------|
| | <u>December 31,</u> | | <u>December 31,</u> | |
| | <u>2006</u> | <u>2005</u> | <u>2006</u> | <u>2005</u> |
| Miscellaneous revenue | 302,747 | 234,775 | 551,019 | 311,239 |
| (Losses)/ Gains on sale of other investments (Note 11) | - | - | (2,450) | 50,304 |
| Provision for capital work in progress | - | (389,251) | - | (389,251) |
| Capitalized commission write-off | - | - | - | (304,184) |
| Gains/ (losses) on sale/ disposal of property, plant and equipment | 5,844 | 24,550 | 12,600 | (79,715) |
| Other | <u>(9,759)</u> | <u>4,897</u> | <u>(86,080)</u> | <u>(5,387)</u> |
| | <u>298,832</u> | <u>(125,029)</u> | <u>475,089</u> | <u>(416,994)</u> |

An amount of SR 249.3 million Included in "Miscellaneous revenue" in the fourth quarter 2006 which represents the settlement of frequency spectrum charges for 2005.

25 BORROWINGS

The Company has renewable short & mid-term facilities agreements in "Murabaha" & "Tawarroq" deals with local banks, with varying maturities spreading to December 2009, and variable commission rates. None of the facilities were utilized during the period.

26 COMMITMENTS AND CONTINGENCIES

Commitments

- (a) The Company enters into commitments during the ordinary course of business for major capital expenditures, primarily in connection with its network expansion programs. Outstanding capital expenditure commitments approximated SR 696 million on December 31, 2006 (December 31, 2005: SR 367 million).
- (b) Certain land and buildings, for use in the Company's operations, are leased under operating lease commitments expiring at various future dates. During the fourth quarter 2006, total rent expense under operating leases amounted to SR 29 million (fourth quarter 2005: SR 25 million).

Contingencies

The Company, in the normal course of business, is subject to proceedings, lawsuits and other claims. However, these matters are not expected to have a material impact neither on the Company's financial position nor on the results of its operations as reflected in the interim financial statements.

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27 SEGMENT INFORMATION

The objective of the Segment Reporting standard promulgated by the Saudi Organization for Certified Public Accountants is to disclose detailed information about each of the main operating segments, and hence its non-application does not affect the overall results of the Company's operations.

Due to the regulation of telecom sector that start growing fast, resulting in very important changes in the identification and segmentation of telecom services sectors, and due to the increase of competition requirements and the company strategic plan to increase the operational efficiency, the company had approved new structure for its sectors that differ from the current structure, which require segment information that is significantly different in its principles from the previous requirements

28 FINANCIAL INSTRUMENTS

Fair value

The carrying values of all financial instruments approximate their fair values at December 31, 2006 and 2005, as discussed below:

- For cash and cash equivalents, accounts receivable and payable and other receivables and payables, fair value is deemed to approximate their carrying amount due to their short-term nature.
- For marketable equity instruments, fair value is based on quoted market prices.
- For government bonds and borrowings, fair value is based on discounted cash flows.

The Company does not utilize derivative financial instruments to manage foreign currency exchange and commission rate risks due to factors explained below:

Commission rate risk

This comprises various risks related to the effect of changes in commission rates on the Company's financial position and cash flows. The Company did not have material assets or liabilities with floating commission rates on December 31, 2006. The Company manages its cash flows by controlling the timing between cash inflows and outflows. Surplus cash is invested to increase the Company's commission income through holding balances in short-term and long-term bank deposits, but the related commission rate risk is not considered to be significant. Consequently, the Company has not used derivative financial instruments to mitigate exposure to commission rate risk.

Currency risk

It is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates. Management monitors fluctuations in foreign currency exchange rates, and believes that the Company is not exposed to significant currency risk since the Company's functional currency is the Saudi Riyal, in which the Company transacts, which is currently fixed, within a narrow margin, against the U.S. dollar.

Credit risk

It is the risk that other parties will fail to discharge their obligations and cause the Company to incur a financial loss. Financial instruments that subject the Company to concentrations of credit risk consist primarily of cash balances and accounts receivable. The Company deposits its cash balances with a

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number of major high credit rated financial institutions and has a policy of limiting its balances deposited with each institution. The Company does not believe that there is a significant risk of non-performance by these financial institutions. The Company does not consider itself exposed to a concentration of credit risk with respect to accounts receivable due to its diverse customer base (residential, professional, large business and public entities) operating in various industries and located in many regions.

Liquidity risk

It is the risk that the Company will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity is managed by periodically ensuring its availability in amounts sufficient to meet any future commitments. The Company does not consider itself exposed to significant risks in relation to liquidity.

The Company believes that it is not exposed to any significant risks in relation to the aforementioned.

29 REDUCTION IN SERVICE RATES

In September 2006, the Company announced high discounts in the SAWA recharge cards and the rates of national and local calls, in addition to earlier announcements of comprehensive varying rate reductions in international calls and mobile, fixed line, internet and leased circuits services.

30 LICENSE

Within the scope of regulating the telecommunications sector, the CITC issued in December 2003 a license to the Company to provide telecommunications services. The Company has raised its objections to the concerned parties on what it considers affecting some of its rights.

31 SUBSEQUENT EVENTS

The Board of Directors, in its meeting of 4 Moharam 1428 H (January 23, 2007), approved interim dividends for the fourth quarter 2006 amounting to SR 3 billion, at the rate of SR 1.50 per share. Resulting in a total dividend for 2006 of SR 5.75 per share.

32 RECLASSIFICATION

Certain amounts in the accompanying comparative financial statements for the period ended December 31, 2005 have been reclassified to conform to the classifications used for the period ended December 31, 2006.