a Saudi Joint Stock Company

Interim Consolidated Financial Statements for the Third Quarter 2011

Interim Consolidated Financial Statements for the Three and Nine-Month Periods Ended September 30, 2011 (Unaudited)

Saudi Telecom Company
(a Saudi Joint Stock Company)
Index to the Interim Consolidated Financial Statements for the Three and Nine-Month Periods Ended September 30, 2011(Unaudited)

Deloitte & Touche
Bakr Abulkhair & Co.
Deloitte.

Dr. Mohamed Al-Amri & Co.
Accountants & Consultants

Report on Review of Interim Consolidated Financial Statements

To the shareholders
Saudi Telecom Company
(a Saudi Joint Stock Company)
Riyadh, Kingdom of Saudi Arabia

Scope of Review

We have reviewed the accompanying interim consolidated balance sheet of Saudi Telecom Company (a Saudi Joint Stock Company) (the "Company") as at September 30, 2011 and the related interim consolidated statements of income for the three and nine month periods then ended and the interim consolidated statement of cash flows for the nine month period then ended and the related notes which form an integral part of these interim consolidated financial statements. These interim consolidated financial statements are the responsibility of the Company's management and have been prepared and presented to us with all the information and explanations which we requested.

We conducted our limited review in accordance with the interim financial statements review standard issued by the Saudi Organization for Certified Public Accountants. A limited 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 in the Kingdom of Saudi Arabia, 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.

Review Result

Based on our limited review, we are not aware of any material modifications that should be made to the accompanying interim consolidated financial statements for them to be in conformity with generally accepted accounting standards in the Kingdom of Saudi Arabia.

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DR. MOHAMED AL-AMRI & CO.

Dhual-Qadah 21, 1432
October 19, 2011

Saudi Telecom Company
(a Saudi Joint Stock Company)
Interim Consolidated Balance Sheet as of September 30, 2011 (Unaudited)
(Saudi Riyals in thousands)

	Notes	2011	2010
ASSETS			
Current assets:			
Cash and cash equivalents		8,374,918	6,335,180
Accounts receivable, net		9,928,875	10,397,256
Prepayments and other current assets		4,680,016	3,689,079
Total current assets		22,983,809	20,421,515
Non-current assets:			
Investments in equity and other		2,643,809	2,482,372
Property, plant and equipment, net		54,048,359	54,142,229
Intangible assets, net	3	29,513,485	32,083,742
Other non-current assets		2,349,036	2,372,345
Total non-current assets		88,554,689	91,080,688
Total assets		**111,538,498**	**111,502,203**
LIABILITIES AND EQUITY			
Current liabilities:			
Accounts payable		7,364,861	7,143,264
Other credit balances - current		3,390,978	4,232,532
Accrued expenses		6,988,594	6,149,719
Deferred revenues – current portion		1,860,845	2,081,532
Murabahas and loans – current portion	4	6,665,917	8,663,867
Total current liabilities		26,271,195	28,270,914
Non-current liabilities:			
Murabahas and loans – non-current portion	4	24,497,029	21,960,236
Provisions for end of service benefits		3,029,847	3,108,953
Other credit balances - non-current		4,932,733	4,778,069
Total non-current liabilities		32,459,609	29,847,258
Total liabilities		58,730,804	58,118,172
Equity			
Shareholders' equity:			
Authorized, issued and outstanding share capital: 2,000,000,000 shares, par value SR 10 per share		20,000,000	20,000,000
Statutory reserve		10,000,000	10,000,000
Retained earnings		18,180,241	15,352,460
Other reserves		(1,368,937)	(694,819)
Financial statements' translation differences		(1,081,402)	21,084
Total shareholders' equity		45,729,902	44,678,725
Non-controlling interests		7,077,792	8,705,306
Total equity		52,807,694	53,384,031
Total liabilities and equity		**111,538,498**	**111,502,203**

The accompanying notes from 1 to 16 form an integral part of these interim consolidated financial statements.

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Saudi Telecom Company
(a Saudi Joint Stock Company)
Interim Consolidated Statement of Income for the Three and Nine-Month Periods Ended September 30, 2011 (Unaudited)
(Saudi Riyals in thousands)

	Note	Three Months ended September 30, 2011	Three Months ended September 30, 2010	Nine Months ended September 30, 2011	Nine Months ended September 30, 2010
Revenue from services		14,015,110	13,232,391	40,971,082	38,343,259
Cost of services	5	(5,942,074)	(5,347,573)	(17,457,728)	(15,963,690)
Gross Profit		8,073,036	7,884,818	23,513,354	22,379,569
Operating Expenses					
Selling and marketing expenses	6	(1,870,606)	(1,696,574)	(5,547,159)	(5,350,176)
Administrative and general expenses	7	(1,004,257)	(770,990)	(2,868,007)	(2,648,391)
Depreciation and amortization	8	(2,197,990)	(2,162,389)	(6,646,366)	(6,428,022)
Total Operating Expenses		(5,072,853)	(4,629,953)	(15,061,532)	(14,426,589)
Operating Income		3,000,183	3,254,865	8,451,822	7,952,980
Other Income and Expenses					
Cost of early retirement program		(7,377)	(311,549)	(296,497)	(313,889)
Finance costs		(691,194)	(730,785)	(1,687,456)	(1,496,097)
Commissions and interest		115,660	187,602	412,784	305,184
Other, net	9	(808,951)	1,340,438	(852,907)	1,878,557
Other income and expenses, net		(1,391,862)	485,706	(2,424,076)	373,755
Net Income before Zakat, Tax and Non-controlling interests		1,608,321	3,740,571	6,027,746	8,326,735
Provision for Zakat		(30,827)	(22,033)	(91,647)	(86,742)
Provision for Tax		(134,416)	(193,859)	(459,587)	(606,648)
Net Income before Non-controlling interests		1,443,078	3,524,679	5,476,512	7,633,345
Non-controlling interests		119,399	(207,880)	(84,545)	(482,530)
Net Income		**1,562,477**	**3,316,799**	**5,391,967**	**7,150,815**
Basic earnings per share on Operating Income (in Saudi Riyals)		**1.50**	**1.63**	**4.23**	**3.98**
Basic (losses) / earnings per share on Other Operations (Other income and expenses) (in Saudi Riyals)		**(0.70)**	**0.24**	**(1.21)**	**0.19**
Basic earnings per share on Net Income (in Saudi Riyals)		**0.78**	**1.66**	**2.70**	**3.58**

The accompanying notes from 1 to 16 form an integral part of these interim consolidated financial statements.

Saudi Telecom Company
(a Saudi Joint Stock Company)
Interim Consolidated Statement of Cash Flows for the Nine-Month Period Ended September 30, 2011 (Unaudited)
(Saudi Riyals in thousands)

	2011	2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	5,391,967	7,150,815
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	6,646,366	6,428,022
Doubtful debts expense	984,557	1,216,132
Earnings from investments accounted for under the equity method	(133,712)	(57,407)
(Gains) on sale/disposal of property, plant and equipment	(223,985)	(905,142)
Changes in:		
Accounts receivable	(2,206,074)	(2,915,670)
Prepayments and other current assets	(733,839)	(197,221)
Other non-current assets	222,630	60,385
Accounts payable	328,447	2,142,308
Other credit balances	(1,147,270)	484,821
Accrued expenses	930,592	52,363
Deferred revenues	233,793	(61,461)
End of service benefits, net	34,476	265,084
Net cash provided by operating activities	10,327,948	13,663,029
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(4,510,338)	(7,735,661)
Investments in equity and other	(30,397)	(107,961)
Proceeds from sale of property, plant and equipment	393,463	1,664,114
Net cash used in investing activities	(4,147,272)	(9,688,600)
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends paid	(3,440,698)	(4,590,532)
Murabahas and loans, net	974,890	(665,978)
Non-controlling interests	(1,390,627)	(92,817)
Net cash used in financing activities	(3,856,435)	(5,349,327)
NET INCREASE / (DECREASE) IN CASH AND CASH EQUIVALENTS	2,324,241	(1,374,898)
CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE PERIOD	6,050,677	7,710,078
CASH AND CASH EQUIVALENTS AT THE END OF THE PERIOD	**8,374,918**	**6,335,180**
Non-cash items:		
Financial statements' translation adjustments	(1,059,331)	837,349
Other reserves	(99,522)	(694,819)

The accompanying notes from 1 to 16 form an integral part of these interim consolidated financial statements.

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. 1010150269 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 has various investments in subsidiaries, associates and joint ventures collectively known for the financial statements purposes as the "Group". The details of these investments are as follows:

Company's Name	Ownership	Accounting Treatment
Arabian Internet and Communications Services Co. (Awal) - Kingdom of Saudi Arabia	100%	Full Consolidation
Telecom Commercial Investment Company –Kingdom of Saudi Arabia	100%	Full Consolidation
STC Bahrain (BSCC) – Bahrain	100%	Full Consolidation
Gulf Digital Media Holding (BSCC) – Bahrain	51%	Full Consolidation
Kuwait Telecom Company Ltd. - Kuwait	26%	Full Consolidation
PT Axis Telekom Indonesia - Indonesia (Refer to Note 3)	80.10%	Full Consolidation
Oger Telecom Ltd. - U.A.E.	35%	Proportionate Consolidation
Binariang GSM Sdn Bhd ("Binariang") - Malaysia	25%	Proportionate Consolidation
Arab Submarine Cables Company Ltd. - Kingdom of Saudi Arabia	50%	Equity Method
Arab Satellite Communications Organization ("Arabsat") - Kingdom of Saudi Arabia	36.66%	Equity Method
Call Center Company–Kingdom of Saudi Arabia	50%	Equity Method

The main activities of the Group comprise the provision of a variety of telecommunications services which include mobile (second and third generations), fixed local national and international telephone services and data services such as data transmission, leased lines and internet services.

2 SIGNIFICANT ACCOUNTING POLICIES

The accompanying interim consolidated financial statements are prepared in accordance with generally accepted accounting standards in the Kingdom of Saudi Arabia. The financial statements of the Group include the financial statements of the Company, its subsidiaries, associates and joint ventures for the period ended September 30, 2011.

The significant accounting policies used for the preparation of the interim consolidated financial statements mentioned below are in conformity with the accounting policies detailed in the audited consolidated financial statements for the year ended December 31, 2010.

Intra-Group balances and transactions and any unrealized gains arising from intra-group transactions, if material, are eliminated upon preparing the interim consolidated financial statements.

The preparation of the financial statements in conformity with generally accepted accounting standards in the Kingdom of Saudi Arabia requires the use of accounting estimates and assumptions which affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the amounts of revenue and expenses during the reporting period.

The significant accounting policies are summarized below:

2-1 Period of the financial statements
The Group's financial year begins on January 1 and ends on December 31 of each Gregorian year.

2-2 Interim results
The results of operations for the interim period may not represent a proper indication of the annual results of operations.

The interim consolidated 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.

2-3 Revenue recognition
Revenue is recognized, net of discounts, 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 approved rates.

- 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.
- Revenue is recognized upon collection when collectability is highly uncertain.

2-4 Cash and cash equivalents
Cash and cash equivalents consist of cash on hand, bank balances and all highly liquid investments with maturity of 90 days or less from the acquisition date.

2-5 Accounts receivable
Accounts receivable are shown at their net realizable value, which represent billings and unbilled usage revenues net of allowances for doubtful debts.

2-6 Offsetting of accounts
The Group has agreements with outside network operators and others which include periodical offsetting with those parties whereby receivables from and payables to the same operator are subject to offsetting

2-7 Allowance for doubtful debts
The Group 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, landline, telex, international settlements…etc), customer category, age of the receivable, the Group's previous experience in debt collection and the general economic situation.

2-8 Inventories

Inventories, which principally comprise 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 Group creates an allowance for obsolete and slow-moving inventories, based on a study of the usage 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 value.

2-9 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 Group are recorded at historical cost.

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:

	Years
Buildings	20 – 50
Telecommunications plant and equipment	3 – 25
Other assets	2 – 8

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. 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-of / sold assets, and the gains or losses are included in the consolidated statement of income.

7. Leases of property, plant and equipment where the Group assumes substantially all benefits and risks of ownership are classified as finance leases. Finance leases are capitalized at the inception of the lease at the lower of the fair value or the present value of the minimum lease payments. Each lease payment is to be allocated between the finance charge which is expensed in the current period and the reduction in the liability under the finance lease.

8. Assets leased under finance leases are depreciated over their estimated useful lives.

9. Assets under concession agreements are depreciated over their estimated useful lives or the contract duration whichever is the shorter.

2-10 Software costs

1) 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 for which the benefits will be received.
2) 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 for which the benefits will be received.
3) Internally developed application software costs are recognized as an 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.
4) Subsequent additions, modifications or upgrades of software programs, whether operating or application packages, are expensed as incurred.
5) Software training and data-conversion costs are expensed as incurred.

2-11 Intangible assets

Goodwill

- Goodwill arises upon the acquisition of stakes in subsidiaries and joint ventures. It represents the excess of the cost of the acquisition over the Group's share in the fair value of the net assets of the subsidiary or the joint venture at the date of purchase. When this difference is negative non-current assets fair values are reduced except for non-current investments in securities by such difference. The adjustment to the non-current assets is done proportionately according to their net book values
- Goodwill is recorded at cost and is reduced by impairment losses (if any).

Spectrum rights and Second/Third Generation licenses

These intangible assets are recorded upon acquisition at cost and are amortized starting from the date of service on a straight line basis over their useful lives or statutory durations, whichever is shorter.

2-12 Impairment of non-current assets

The Group reviews periodically non-current assets to determine whether there are indications that they may be impaired. When such indications are present the recoverable amount of the asset is estimated. If the recoverable amount of the asset cannot be determined individually, then the cash generating unit to which the asset relates is used instead. The excess of the carrying amount of the asset over its recoverable amount is treated as impairment in its value to be recognized in the statement of income of the period in which it occurs. When it becomes evident that the circumstances which resulted in the impairment no longer exist, the impairment amount (except for goodwill) is reversed and recorded as income in the interim consolidated statement of income of the period in which such reversal is determined. Reversal of an impairment loss does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset in previous financial periods.

2-13 Investments

Subsidiaries

Entities controlled by the Group are classified as subsidiaries. Control is defined as the power to use, or direct the use, of another entity's assets in order to gain economic benefits. The financial statements of subsidiaries are included in the consolidated financial statements of the Group from the date control commences until the date it ceases.

Investments in joint ventures

A joint venture is a contractual arrangement whereby the Group and other parties undertake an economic activity which is subject to joint control that is when the strategic financial and operating policy decisions relating to the activities of the joint venture require the unanimous consent of all the parties sharing control.

Contractual arrangements that involve a separate entity in which each venture has an interest are referred to as jointly controlled entities.

In the consolidated financial statements, the Group reports its interests in jointly controlled entities using proportionate consolidation, whereby the Group's share of the assets, liabilities, income and expenses of jointly controlled entities is combined on a line-by-line basis with the equivalent items in the Company's financial statements.

Goodwill arising on the acquisition of the Group's interest in a jointly controlled entity is accounted for in accordance with the Group's accounting policy for goodwill.

Investments accounted for under the equity method (Associates)

Associates are those corporations or other entities on which the Group exercises significant influence, but which it does not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Significant influence is the power to participate in the financial and operating policy decisions of the associate but not the power to exercise control over those polices.

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 consolidated balance sheet as non-current assets, and the Company's share in the net income (loss) of the investee is presented in the interim consolidated statement of income.

Other investments

Available for sale marketable securities that do not lead to control or significant influence 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 equity in the consolidated balance sheet. Losses resulting from permanent declines in fair values below costs are recorded in the interim consolidated 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 in the interim consolidated statement of income.

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 consolidated statement of income in the period in which the decline occurs.

2-14 Zakat

The Group calculates and reports the zakat provision based on the zakat base in its consolidated financial statements in accordance with Zakat rules and principles in the Kingdom of Saudi Arabia. Adjustments arising from final zakat assessments are recorded in the period in which such assessments are approved by the Department of Zakat and Income Tax.

2-15 Taxes

Taxes relating to entities invested in outside the Kingdom of Saudi Arabia are calculated in accordance with tax laws applicable in those countries.

Deferred taxes

Deferred tax assets of foreign entities are recognised only to the extent that it is probable that future taxable profits will be available against which the temporary differences of the foreign entities can be utilized. This involves judgement regarding the future financial performance of the particular entity in which the deferred tax assets has been recognised.

2-16 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 laws applicable in the Kingdom of Saudi Arabia and the countries invested in.

2-17 Foreign currency transactions

Functional and presentation currency

Items included in the consolidated financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the "functional currency"). These interim consolidated financial statements are presented in Saudi Riyals.

Transactions and balances

Balances of monetary assets and liabilities denominated in foreign currencies of specific amounts are translated using rates of exchange prevailing at the interim consolidated 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 consolidated statement of income.

Entities of the Group (translation of financial statements)

The results and financial position of all Group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- Items of shareholders' equity (except retained earnings) are translated at the rate prevailing on the acquisition date.
- Retained earnings are translated as follows: retained earnings translated at the end of last year plus interim net income for the period as per the translated interim income statement less declared dividends translated at the rate prevailing on the date of declaration.
- Income statement items are translated using the weighted average rate for the period. Material gains and losses are translated at the rate prevailing on the date of their occurrence.

- All resulting exchange differences, if material, are recognised as a separate component of shareholders' equity.

When those entities are partially sold or disposed of, exchange differences that were recorded in shareholders' equity are recognized in the interim consolidated statement of income as part of the gains or losses on sale.

2-18 <u>Contingent liabilities</u>

A contingent liability is a possible obligation which may arise from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the Group, or a present obligation that is not recognized because it is not probable that an outflow of resources will be required to settle the obligation. If the amount of the obligation cannot be measured with sufficient reliability, then the Group does not recognize the contingent liability but discloses it in the interim consolidated financial statements.

2-19 <u>Cost of services</u>

Cost of services represents all costs incurred by the Group on rendering of services which are directly related to revenues generated from the use of the network, and are recognized in the periods of relevant calls, including:-

- Government charges are the costs incurred by the Group for the right to provide the telecommunications services in the Kingdom and the investees countries, including the use of the frequency spectrum.
- Access charges represent the costs to connect to foreign and domestic carriers' networks related to telecommunications services for the Group's clients.

2-20 <u>Selling and marketing expenses</u>

Selling and marketing expenses represent all costs incurred by the Group, which are directly related to the marketing, distribution and sale of services. They are expensed as incurred when it is not possible to determine the relevant benefiting periods. Otherwise, they are charged to the relevant periods.

2-21 <u>General and administrative expenses</u>

General and administrative expenses represent all the operating expenses incurred by the Group that cannot be directly linked to the costs of services or selling and marketing expenses. They are expensed as incurred when it is not possible to determine the relevant benefiting periods. Otherwise, they are charged to the relevant periods.

2-22 <u>Earnings per share</u>

Earnings per share are calculated by dividing operating income and other operations (other income and expenses) before eliminating non-controlling interests, and net income for the financial period, by the weighted average number of shares outstanding during the period.

2-23 <u>Financial derivatives</u>

The Group uses derivative financial instruments to manage its exposure to interest rate and foreign exchange rate risk, including forward currency contracts and interest rate swaps. Derivatives are initially measured at fair value at the date the derivative contract is entered into and are subsequently re-measured at fair value at the date of each reporting period. The resulting gain or loss is recognized in the consolidated statement of income immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in the interim consolidated statement of income depends on the nature of the hedge relationship.

The Group designates certain derivatives as either hedges of the fair value of recognized assets and liability or an unrecognized commitment except for foreign currency risk (fair value hedge), hedges of variability in cash flows that are either attributable to a particular risk associated with a designated asset or liability or the foreign currency risk in an unrecognized firm commitment (cash flow hedge).

Changes in fair value of derivatives that are designated and qualify as fair value hedges are recognized in the consolidated statement of income, together with any changes in the fair value of the hedged assets or liabilities. In the case of cash flow hedges, the effective portion of changes in fair value of the derivatives that are designated and qualify as cash flow hedges is recognized in equity. The gain or loss relating to the ineffective portion is recognized immediately in the interim consolidated statement of income.

Hedge accounting is discontinued when the Group either revokes the hedge relationship, the hedging instrument is sold, terminated, or exercised, or it no longer meets the requirements of hedge accounting. Any gain/loss accumulated in the equity at the time remains in equity and is recognized when the forecast transaction is ultimately recognized in the consolidated statement of income. When the forecast transaction is no longer expected to occur the gain or loss is recognized immediately in the interim consolidated statement of income.

2-24 <u>Related parties</u>

During the ordinary course of business, the Group deals with related parties, all transactions of relative importance with related parties are disclosed regardless of the presence or absence of balances for these transactions by the end of the financial year. Transactions of the same nature are grouped into a single disclosure, with the exception of separate disclosures for transactions, which are necessary to understand the impact of the related party transactions on the financial data of the Group.

3 INTANGIBLE ASSETS, NET

Intangible assets include goodwill arising on the acquisition of the Group’s shares in Binariang, PT Axis Telekom and Oger Telecom Ltd, in addition to the Company’s share in the goodwill recorded in the financial statements of Binariang and Oger Telecom Ltd.

The companies invested in, which resulted in intangible assets, are:

<u>Binariang GSM Sdn Bhd “Binariang” – Malaysia</u>

Binariang is a Malaysian investment holding company that had owned 100% of Maxis, an un-listed Malaysian holding group operating in the telecommunications sector in Malaysia. In November 2009, 30% of Maxis’ shares were offered for public subscription and the company was subsequently listed on the Malaysian stock market. The percentage ownership of Binariang in Maxis has accordingly reduced to 70%.

Binariang has other investments in telecommunications companies in India (Aircel company) and Indonesia (PT Axis Telekom).

In September 2007, the Company acquired 25% of its MYR 20 billion share capital, equivalent to approximately SR 22 billion.

The official authorities in India are currently collecting and studying the information raised in the media on Aircel company, a subsidiary of the Group Binariang GSM Holding. In view of the current facts and available information, the management does not expect an impact on the Group's results as of 30 September 2011.

PT Axis Telekom Indonesia – Indonesia – (formerly known as NTS (AXIS)

PT Axis Telekom obtained the license to operate a third generation mobile network in Indonesia and it started the commercial provisioning of this service in the first quarter of 2008. The Company acquired 51% of its IDR 3.2 trillion share capital in September 2007, equivalent to approximately SR 1.3 billion. On April 6, 2011, the Company increased its share in PT Axis Telekom by 29.10% to 80.10% (refer to Note 14)

Oger Telecom Ltd. - U.A.E.

Oger Telecom Ltd. is a company registered in Dubai, the United Arab Emirates, having investments in companies operating in the telecommunications sector in Turkey and South Africa. The Company acquired 35% of its USD 3.5 billion share capital, equivalent to approximately SR 13.2 billion in April 2008.

Kuwait Telecom Company (VIVA) (KSCC) – Kuwait

In December 2007, the Company acquired 26% of the KD 50 million share capital of Kuwait Telecom Company, equivalent to approximately SR 650 million. This company operates in the field of mobile services, and commenced commercial operations on December 4, 2008.

STC Bahrain (VIVA) (BSCC) – Bahrain

STC Bahrain (BSC Closed) was established in the Kingdom of Bahrain in February 2009, and the Company owns 100% of its BHD 75 million share capital, equivalent to SR 750 million. This company operates in the field of mobile services, international telecommunications, broadband and other related services in the Bahraini market, and commenced commercial operations on March 3, 2010.

Net intangible assets consist of the following as of September 30, 2011:

(Thousands of Saudi Riyals)	2011	2010
Licenses	15,010,436	15,781,654
Goodwill arising on the consolidation of financial statements	4,932,120	5,667,184
Trade marks and contractual relations	3,061,708	4,024,116
Spectrum usage rights	2,356,527	2,481,338
Goodwill arising on the acquisition of 25% in Binariang	1,753,114	1,753,115
Goodwill arising on the acquisition of 35% in Oger Telecom Ltd.	826,395	826,395
Goodwill arising on the acquisition of 80.10% in PT Axis Telekom (refer to Note 14)	661,208	713,191
Others	911,977	836,749
	29,513,485	32,083,742

4 MURABAHAS AND LOANS

Murabahas and loans consist of:

(Thousands of Saudi Riyals)	2011	2010
Current portion	6,665,917	8,663,867
Non-current portion	24,497,029	21,960,236
	31,162,946	30,624,103

As of September 30, 2011, the Group's share in the investees' murabahas and loans amounted to SR 22,452 million (September 30, 2010: SR 19,359 million)

5 COST OF SERVICES

Cost of services consists of the following:

(Thousands of Saudi Riyals)	Three Months ended September 30, 2011	Three Months ended September 30, 2010	Nine Months ended September 30, 2011	Nine Months ended September 30, 2010
Access charges	2,406,028	2,137,264	6,486,052	6,224,095
Government charges (*)	1,533,735	1,473,646	4,675,651	4,256,650
Repairs and maintenance	664,504	453,552	1,931,812	1,614,625
Employee costs	650,483	657,762	2,111,135	2,218,750
Rent of equipment, property and vehicles	247,752	193,161	858,615	530,680
Utilities	213,895	101,051	461,159	288,134
Other	225,677	331,137	933,304	830,756
	5,942,074	5,347,573	17,457,728	15,963,690

"Other" comprises different items, the main ones being: printing of telephone cards, consultancy fees, security and safety expenses and postage and courier expenses.

(*)The details of government charges are as follows:

(Thousands of Saudi Riyals)	Three Months ended September 30, 2011	Three Months ended September 30, 2010	Nine Months ended September 30, 2011	Nine Months ended September 30, 2010
The Company	1,109,253	1,113,403	3,307,247	3,330,218
Other Group companies	424,482	360,243	1,368,404	926,432
	1,533,735	1,473,646	4,675,651	4,256,650

6 SELLING AND MARKETING EXPENSES

Selling and marketing expenses consist of the following:

(Thousands of Saudi Riyals)	Three Months ended September 30, 2011	Three Months ended September 30, 2010	Nine Months ended September 30, 2011	Nine Months ended September 30, 2010
Advertising and publicity	645,997	511,383	1,939,953	1,791,919
Employee costs	472,823	443,701	1,464,664	1,449,414
Doubtful debts expense	326,395	431,488	984,557	1,216,132
Printing of telephone cards and stationery	89,206	99,816	294,027	270,771
Repairs and maintenance	83,977	37,767	138,273	95,117
Consultancy, legal and professional fees	28,590	14,770	106,485	43,159
Security and safety expenses	33,987	35,137	102,376	93,631
Others	189,631	122,512	516,824	390,033
	1,870,606	1,696,574	5,547,159	5,350,176

"Others" comprises different items, the main ones being: rent of equipment, property and motor vehicles, postage and courier.

7 GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses consist of the following:

(Thousands of Saudi Riyals)	Three Months ended September 30, 2011	Three Months ended September 30, 2010	Nine Months ended September 30, 2011	Nine Months ended September 30, 2010
Employee costs	422,208	324,568	1,374,447	1,290,652
Repairs and maintenance	77,973	79,378	255,027	287,183
Rent of equipment, property and vehicles	68,928	47,637	194,896	168,506
Consultancy & legal and professional fees	80,223	60,012	219,610	226,920
Utilities	41,736	36,221	139,332	124,397
Security and safety expenses	23,526	20,518	67,859	57,091
Others	289,663	202,656	616,836	493,642
	1,004,257	770,990	2,868,007	2,648,391

"Others" comprises different items, the main ones being: insurance premiums, stationery, freight, handling, postage and courier expenses.

8 DEPRECIATION AND AMORTIZATION

Depreciation and amortization consist of the following:

(Thousands of Saudi Riyals)	Three Months ended September 30, 2011	Three Months ended September 30, 2010	Nine Months ended September 30, 2011	Nine Months ended September 30, 2010
Depreciation	1,878,436	1,889,544	5,672,156	5,638,356
Amortization	319,554	272,845	974,210	789,666
	2,197,990	2,162,389	6,646,366	6,428,022

9 OTHER INCOME AND EXPENSES, NET

This item consists of the following:

(Thousands of Saudi Riyals)	Three Months ended September 30, 2011	Three Months ended September 30, 2010	Nine Months ended September 30, 2011	Nine Months ended September 30, 2010
Miscellaneous revenue	404,674	1,094,616	1,239,493	1,971,825
(Losses) / Gains on foreign currency exchange fluctuations	(779,869)	254,220	(1,082,745)	352,721
Miscellaneous expenses	(433,756)	(8,398)	(1,009,655)	(445,989)
	(808,951)	1,340,438	(852,907)	1,878,557

The increase in losses from foreign currency exchange fluctuations is attributed to the losses recorded by Oger Telecom company Ltd as a result of Turkish Lira and the South African Rand exchange rates fluctuation against the US Dollar. Miscellaneous revenue in third quarter 2010 includes an amount of SR 728 million which represents gains from the sale of fixed assets (towers) in one of Binariang`s subsidiaries.

10 COMMITMENTS AND CONTINGENCIES

Commitments

(a) The Group 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 2,798 million on September 30, 2011 (September 30, 2010: SR 4,178 million).
(b) Certain land and buildings, for use in the Group's operations, are leased under operating lease commitments expiring at various future dates. During the third quarter and the nine-month period ended September 30, 2011, total rent expense under operating leases amounted to SR 218 million and SR 617 million, respectively (third quarter and the nine-month period ended September 30, 2010: SR 112 million and SR 336 million, respectively).

Contingencies

The Group, 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 Group's financial position or on the results of its operations as reflected in the interim consolidated financial statements.

11 FINANCIAL INSTRUMENTS

Fair value
Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. The carrying amounts for all financial instruments do not differ materially from their fair values as at 30 September 2011 and 2010 which are as follows:

- Cash & cash equivalents, accounts receivable, payables and other debit and credit balances fair values are considered approximate to their recorded amounts, due to their short term nature.
- Fair values of shares in active markets rely on fair market values.
- Fair values of government bonds and loans rely on discounted cash flows.

Management does not believe that the fair values of the Group's financial assets and liabilities differ materially from their carrying values.

Commission rate risk
Commission rate risk comprises various risks related to the effect of changes in commission rates on the Group's financial position and cash flows. The Group manages its cash flows by controlling the timing between cash inflows and outflows. Surplus cash is invested to increase the Group'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.

Currency risk
Currency risk 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 enters into hedging agreements where possible to reduce the currency risk; the official currency of the Group is the Saudi Riyal, the base currency dealing by the Group and its price is currently fixed with a minor margin against the U.S. dollar.

Credit risk
Credit risk is the risk that other parties will fail to discharge their obligations and cause the Group to incur a financial loss. Financial instruments that subject the Group to concentrations of credit risk

consist primarily of cash balances and accounts receivable. The Group deposits its cash balances with a number of major high credit-rated financial institutions and has a policy of limiting its balances deposited with each institution. The Group does not believe that there is a significant risk of non-performance by these financial institutions. The Group 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

Liquidity risk is the risk that the Group 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 Group does not consider itself exposed to significant risks in relation to liquidity.

12 FINANCIAL DERIVATIVES

The Group enters into interest rate swap agreements to hedge its interest rate risk of expected future cash outflows in relation to its floating rate debt. The notional principal amount and fair value of these hedges as of September 30, 2011 was SR 11,387 million and SR 596 million respectively (2010: The notional principal amount and fair value of these hedges as of September 30, 2010 was SR 7,157 million and SR 695 million respectively) The fair value of the effective impact of these hedges is included in other reserves in the interim consolidated balance sheet.

13 SEGMENT INFORMATION

- According to the main activities of the Group

The Group has identified its operating segments by the type of service provided by the Group and transactions between operating segments occur in accordance with the normal trade provisions and terms. There are no other substantial revenues or expenses between segments.

The main operating segments of the Group comprise:

- GSM, for which the main services are: mobile, third generation services, prepaid cards, international roaming and messages.
- PSTN, for which the main services are: fixed line, card telephones, interconnect and international calls.
- DATA, for which the main services are: leased data transmission circuits, DSL and internet.
- Un-allocated, containing items which could not be linked with the main operating segments of the Group.

The segmental information for the Nine-Month period ended September 30, 2011 was as follows:

(Thousands of Saudi Riyals)	GSM	PSTN	DATA	Un-allocated	TOTAL
Revenue from services	27,448,354	6,279,267	6,847,875	395,586	40,971,082
Interconnect revenues	1,925,957	5,989,445	1,025,269	(51,416)	8,889,255
Interconnect expenses	(4,570,727)	(1,607,814)	(2,658,490)	(52,224)	(8,889,255)
Net revenue from services	24,803,584	10,660,898	5,214,654	291,946	40,971,082
Depreciation and amortization	3,222,084	2,812,232	478,435	133,615	6,646,366
Net income	5,257,162	(236,841)	1,070,731	(699,085)	5,391,967
Total assets	40,557,878	36,697,847	8,715,314	25,567,459	111,538,498
Total liabilities	20,470,971	12,229,951	2,135,169	23,894,713	58,730,804

The following table shows the segmental information for the Nine-Month period ended September 30, 2010:

(Thousands of Saudi Riyals)	GSM	PSTN	DATA	Un-allocated	TOTAL
Revenue from services	25,343,896	7,514,137	5,243,483	241,743	38,343,259
Interconnect revenues	1,741,224	4,776,856	644,153	-	7,162,233
Interconnect expenses	(4,374,137)	(1,416,920)	(1,371,176)	-	(7,162,233)
Net revenue from services	22,710,983	10,874,073	4,516,460	241,743	38,343,259
Depreciation and amortization	3,016,689	2,845,442	425,317	140,574	6,428,022
Net income	5,389,530	926,795	875,703	(41,213)	7,150,815
Total assets	40,135,695	38,760,794	6,879,752	25,725,962	111,502,203
Total liabilities	16,937,748	13,944,912	1,343,066	25,892,446	58,118,172

- According to Group operations

The Group has divided its operations into domestic and international operations

The following table shows the segmental information according to Group operations:

For the Nine-Month period ended September 30, 2011

	Domestic Operations	International Operations					
	KSA	STC-Bahrain	GDMH	VIVA-Kuwait	PT Axis	OTL	Binariang
Operating revenues	27,253,639	567,080	276,821	900,741	394,690	8,608,314	2,969,797
Total assets (*)	76,356,418	2,040,466	422,524	1,720,419	3,564,227	22,015,078	20,355,244

The financial statements consolidation adjustments relating to intangible assets and related parties transactions amounted to SR (14,771,808) thousand

For the Nine-Month period ended September 30, 2010

	Domestic Operations	International Operations					
	KSA	STC-Bahrain	GDMH	VIVA-Kuwait	PT Axis	OTL	Binariang
Operating revenues	26,321,185	212,688	159,560	576,543	107,281	8,137,973	2,828,029
Total assets (*)	73,125,636	1,498,129	366,278	1,591,593	2,306,694	24,908,293	21,963,384

The financial statements consolidation adjustments relating to intangible assets and related parties transactions amounted to SR (14,257,672) thousand

14 INCREASE OF THE GROUP`S SHARE IN PT AXIS TELEKOM INDONESIA - (formerly known as NTS (AXIS))

On April 6, 2011, the Group acquired an additional 29.10% in PT Axis Telekom, known by the Axis brand name, that was based on an agreement signed on March 9, 2011 between the Company and Maxis Communications Berhad (MCB) one of the wholly owned subsidiaries of Binariang Group to restructure PT Axis Telekom. The agreement was approved by the appropriate regulatory authorities in Indonesia and the conditions necessary for the completion of the agreement were fulfilled on April 6, 2011. This resulted in the following:

- MCB provided a loan amounting to USD 69 million, equivalent to approximately SR 259 million to PT Axis Telekom.

- Loan waiver by MCB of its rights to receive its loan repayment due from PT Axis Telekom amounting to USD 412 million, equivalent to approximately SR 1,545 million.

- MCB sold 1,864,489,495 of its shares in PT Axis Telekom to the Company, thus increasing the Company's direct stake in PT Axis Telekom from 51% to 80.1% and reducing MCB`s stake in PT Axis Telekom from 44% to 14.9%, with the survival of the local partner's share of 5%.

- The Company is committed to provide another loan amounting to USD 371 million, equivalent to approximately SR 1,391 million to be paid according to PT Axis Telekom's operational needs and without finance cost. The Group paid USD 130 million, equivalent to SR 488 million of this loan to PT Axis Telekom during the six months ended September 30, 2011.

- The Company is committed to provide a letter of support in order to obtain the necessary bank financing for PT Axis Telekom according to the approved finance plan for the next five years.

The net realized gains at the Group level as a result of the restructuring of PT Axis Telekom amounted to SR 286 million. The fair values of net assets at the date of acquisition were not used for the calculation of goodwill arising on the Company's acquisition of an additional 29.10% of PT Axis Telekom. Fair values of net assets will be used to determine the goodwill pending relevant valuation reports expected to be finished during the year 2011. The amounts recorded as intangible assets might accordingly be re-allocated.

The Group was treating its investment in PT Axis Telekom (the joint venture project) according to the proportionate consolidation method. As a result of the restructuring of PT Axis Telekom which resulted in an increase in the ownership share of the Company to 80.10% instead of 51%, starting from the second quarter, 2011, the Group started treating its investment in PT Axis Telekom (a subsidiary) according to the full consolidation method.

15 SUBSEQUENT EVENTS

The Board of Directors, in its meeting held on Wednesday 21 Dhual- Qa'dah 1432 H (October 19, 2011), approved the interim consolidated financial statements for the third quarter of 2011 and approved interim dividends for the third quarter of 2011 amounting to SR 1,000 million, at the rate of SR 0.50 per share.

16 RECLASSIFICATION

Certain comparatives of the period ended September 30, 2010 have been reclassified to conform to the classifications used for the period ended September 30, 2011.