الاتصالات السعودية
SAUDI TELECOM

a Saudi Joint Stock Company

Financial Statements for the Year Ended December 31, 2005

Saudi Telecom Company
(a Saudi Joint Stock Company)
Index to the Financial Statements for the Year Ended December 31, 2005

Al Juraid & Company
Member firm of PricewaterhouseCoopers
P.O. Box 8282
Riyadh 11482
Saudi Arabia
Tel: 966 (1) 4654240
Fax: 966 (1) 4651663

Deloitte & Touche
Bakr Abulkhair & Co.
Public Accountants - License No. 96
P.O. Box 213, Riyadh 11411
Kingdom of Saudi Arabia
Tel: +966 (1) 4630018
Fax: +966 (1) 4630865
www.deloitte.com
Head Office: Riyadh

INDEPENDENT AUDITORS' REPORT

To the shareholders
Saudi Telecom Company
Riyadh, Saudi Arabia

We have audited the accompanying balance sheet of Saudi Telecom Company (a Saudi joint stock company) ("the Company") as of December 31, 2005 and the statements of income, shareholders' equity and cash flows for the year then ended, and the notes which form an integral part of these financial statements. These financial statements, which were prepared by the Company in accordance with the articles of the Regulations for Companies and presented to us with all the necessary information and explanations which we required, are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards in the Kingdom of Saudi Arabia. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 31 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.

In our opinion, except for what has been discussed in the preceding paragraph, the above mentioned financial statements taken as a whole:

- Present fairly, in all material respects, the financial position of the Company as of December 31, 2005 and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting standards in the Kingdom of Saudi Arabia appropriate to the circumstances of the Company; and
- Comply with the requirements of the Regulations for Companies and the Company's Articles of Association as they relate to the preparation and presentation of these financial statements.

Al Juraid & Company
Member Firm of PricewaterhouseCoopers

Sami B. Al Sarraj
Registration No. 165

Deloitte & Touche
Bakr Abulkhair & Co.

Bakr A. Abulkhair
Registration No. 101

16 Muharram, 1427H
February 15, 2006

Saudi Telecom Company
(a Saudi Joint Stock Company)
Balance Sheet as of December 31, 2005

	Notes	2005 SR'000	2004 SR'000
ASSETS			
Current assets:			
Cash and cash equivalents	3	4,004,821	5,013,705
Short-term investments	4	3,695,000	1,735,000
Accounts receivable, net	5	3,623,634	3,133,562
Inventories, net	6	153,288	217,650
Prepayments and other current assets	7	473,401	196,551
Total current assets		11,950,144	10,296,468
Non-current assets:			
Property, plant and equipment, net	8	30,532,590	30,781,642
Intangible assets	9	753,750	-
Investments accounted for under the equity method	10	892,004	802,018
Other investments	11	100,033	155,682
Other non-current assets	12	515,355	82,017
Total non-current assets		32,793,732	31,821,359
Total assets		**44,743,876**	**42,117,827**
LIABILITIES AND SHAREHOLDERS' EQUITY			
Current liabilities:			
Accounts payable	13	2,605,975	2,728,601
Dividends payable	14	207,249	47,778
Other payables	15	2,396,366	2,878,935
Accrued expenses	16	2,915,864	1,580,116
Deferred revenue - current		1,329,277	1,323,811
Total current liabilities		9,454,731	8,559,241
Non-current liabilities:			
Deferred revenue		821,168	1,006,600
Employees' end of service benefits	17	1,612,540	1,643,410
Total non-current liabilities		2,433,708	2,650,010
Total liabilities		11,888,439	11,209,251
Shareholders' equity:			
Authorized, issued and outstanding shares:			
300,000,000 shares, par value SR 50 per share	18 , 34	15,000,000	15,000,000
Statutory reserve	19	4,538,568	3,293,882
Retained earnings		13,320,211	12,618,036
Unrealized loss on other investments	11	(3,342)	(3,342)
Total shareholders' equity		32,855,437	30,908,576
Total liabilities and shareholders' equity		**44,743,876**	**42,117,827**

The accompanying notes 1 to 36 form an integral part of these financial statements.

Saudi Telecom Company
(a Saudi Joint Stock Company)
Statement of Income for the Year Ended December 31, 2005
(Saudi Riyals in thousands)

	Notes	2005	2004
Operating Revenues			
Wireless		23,514,231	20,911,997
Wireline		9,025,712	9,586,666
Total operating revenues	20	32,539,943	30,498,663
Operating Expenses			
Government charges	21	(5,175,322)	(6,159,567)
Access charges		(2,519,941)	(2,119,774)
Employee costs	22	(3,883,083)	(3,809,779)
Depreciation	8	(3,836,211)	(4,261,391)
Administrative and marketing expenses	23	(2,140,781)	(2,088,212)
Repairs and maintenance		(1,622,552)	(1,580,214)
Total operating expenses		(19,177,890)	(20,018,937)
Operating Income		13,362,053	10,479,726
Other Income and Expenses			
Cost of manpower improvement program	24	(519,903)	(580,008)
Commissions	3 , 4, 11	207,274	63,368
Earnings of investments accounted for under the equity method	10	106,680	31,161
Other, net	25	(416,994)	(427,163)
Other income and expenses, net		(622,943)	(912,642)
Net Income before Zakat		12,739,110	9,567,084
Provision for Zakat	26	(292,249)	(252,756)
Net Income		**12,446,861**	**9,314,328**
Earnings per share in Saudi Riyals		**41.49**	**31.05**

The accompanying notes 1 to 36 form an integral part of these financial statements.

Saudi Telecom Company
(a Saudi Joint Stock Company)
Statement of Cash Flows for the Year Ended December 31, 2005
(Saudi Riyals in thousands)

	2005	2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	12,446,861	9,314,328
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	3,836,211	4,261,391
Doubtful debts expense	272,393	653,152
Provision for capital work in progress	389,251	-
Capitalized commission write-off	304,184	-
Losses on sale/ disposal of property, plant and equipment	79,715	466,849
Earnings from investments accounted for under the equity method	(106,680)	(31,161)
Gains on sale of other investments	(50,304)	(3,073)
Changes in:		
Accounts receivable	(762,465)	(771,660)
Inventories	64,362	86,189
Prepayments and other current assets	(276,850)	(18,546)
Other non-current assets	(433,338)	20,504
Accounts payable	(122,626)	(214,761)
Other payables	(482,569)	157,216
Accrued expenses	1,335,748	(531,937)
Deferred revenue	(179,966)	(530,373)
Employees' end of service benefits	(30,870)	67,457
Net cash provided by operating activities	16,283,057	12,925,575
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(4,389,144)	(3,749,656)
Short-term investments	(1,960,000)	372,000
Intangible assets	(753,750)	-
Proceeds from sale of other investments	105,953	25,322
Proceeds from sale of property, plant and equipment	28,835	-
Dividends received from investments accounted for under the equity method	16,694	28,819
Acquisition of other investments	-	(100,000)
Net cash used in investing activities	(6,951,412)	(3,423,515)
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends paid	(10,340,529)	(7,769,470)
Proceeds from borrowings	-	1,800,000
Repayments of borrowings	-	(1,800,000)
Net cash used in financing activities	(10,340,529)	(7,769,470)
NET (DECREASE)/ INCREASE IN CASH AND CASH EQUIVALENTS	(1,008,884)	1,732,590
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	5,013,705	3,281,115
CASH AND CASH EQUIVALENTS AT END OF YEAR	**4,004,821**	**5,013,705**

The accompanying notes 1 to 36 form an integral part of these financial statements.

Saudi Telecom Company
(a Saudi Joint Stock Company)
Statement of Changes in Shareholders' Equity for the Year Ended December 31, 2005
(Saudi Riyals in thousands)

	Notes	Common Shares	Statutory Reserve	Retained Earnings	Unrealized Loss On Other Investments	Total Shareholders' Equity
Balance at December 31, 2003		**15,000,000**	**2,362,449**	**12,035,141**	**(2,952)**	**29,394,638**
Net income		-	-	9,314,328	-	9,314,328
Dividends	14	-	-	(7,800,000)	-	(7,800,000)
Transfer to statutory reserve	19	-	931,433	(931,433)	-	-
Unrealized loss on other investments	11	-	-	-	(390)	(390)
Balance at December 31, 2004		**15,000,000**	**3,293,882**	**12,618,036**	**(3,342)**	**30,908,576**
Net income		-	-	12,446,861	-	12,446,861
Dividends	14	-	-	(10,500,000)	-	(10,500,000)
Transfer to statutory reserve	19	-	1,244,686	(1,244,686)	-	-
Balance at December 31, 2005		**15,000,000**	**4,538,568**	**13,320,211**	**(3,342)**	**32,855,437**

The accompanying notes 1 to 36 form an integral part of these 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. 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. The 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 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 31of the same year.

b) 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 minutes of traffic 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.
- Revenue is recognized upon collection when collectability is highly uncertain.
- Non-refundable up-front activation fees received from customers are deferred and recognized over the estimated service lives of the customers.
- Wireless revenues are composed mainly of mobile, international roaming and pager services, while wireline revenues are composed mainly of fixed lines, international settlements, leased circuits, data and internet services.

c) Cash and cash equivalents

Cash and cash equivalents consist of cash on hand, balances with banks and all highly liquid investments with a maturity of 90 days or less when purchased. Cash and cash equivalents are stated at cost.

d) Accounts receivable

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

e) 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.

f) 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 will be based on groups or categories of inventory items, taking into consideration the items which may require significant reductions in their values.

g) 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 included in these financial statements 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.
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	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 cases 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 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-of/ sold assets, and the gains or losses are included in the statement of income.

h) <u>Software costs</u>

- 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 possibility 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 as incurred, and where the costs of operating systems software cannot be identified separately from the associated hardware costs, then 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.

i) <u>Investments accounted for under the equity method</u>

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

j) 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 balance sheet and in the statement of changes in shareholders' equity. Losses resulting from permanent declines in fair values below costs are recorded in the 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 statement of income in the period in which the declines occur.
- Gains and loses resulting from sales of available for sale securities are recorded in the period of sale, and previously recorded unrealized gains and losses are reversed.

k) 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 year in which such assessments are approved.

l) 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 balance sheet date, using the employees' latest salaries and allowances and years of service in the Company.

m) 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 balance sheet date.
- Gains and losses arising on the settlement of foreign currency transactions, and unrealized gains and losses resulting from the translation to Riyals of foreign currency denominated monetary balances are recorded in the statement of income.

n) Government charges

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

o) 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.

p) 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.

q) Earnings per share

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

3 CASH AND CASH EQUIVALENTS

During 2005 the Company converted its invested cash surplus with several local banks from time deposits to Murabaha deals maturing within less than 90 days. The average rate of commission during the year on the Murabaha was 4.48%. Total commission earned during the year on the Murabaha was SR 88.7 million. Commission earned on time deposits before conversion to Murabaha amounted to SR 28.6 million with average commission rate of 3.05%.

Investments during 2004 were through bank time deposit accounts. Average commission rate on deposits maturing within less than 90 days was 2.1%. Total commission earned on these deposits during 2004 amounted to SR 35.6 million.

Commission earned on current accounts during 2005 amounted to SR 11.2 million (2004: SR 4.4 million).

Cash and cash equivalents at the end of the year include balances of collection accounts at various 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 year, cash and cash equivalents consisted of the following:

(Thousands of Saudi Riyals)

	2005	2004
Collection accounts	2,492,295	2,381,874
Short-term Murabaha	1,256,500	-
Short-term deposits	-	2,421,000
Disbursement accounts	256,026	210,831
	4,004,821	5,013,705

4 SHORT-TERM INVESTMENTS

During 2005 the Company converted its invested cash surplus with several local banks from time deposits to Murabaha deals maturing within more than 90 days. The average rate of commission during the year on the Murabaha was 5.62%. Total commission earned during the year on the Murabaha was SR 46.1 million. Commission earned on time deposits before conversion to Murabaha amounted to SR 28.3 million with average commission rate of 3.54%.

Investment of cash surplus during 2004 was through bank time deposit accounts. Average commission rate on deposits maturing within more than 90 days was 2.2%. Total commission earned on these deposits during 2004 amounted to SR 23.4 million.

5 ACCOUNTS RECEIVABLE, NET

(a) Accounts receivable on December 31 consisted of the following:

(Thousands of Saudi Riyals)

	2005	2004
Billed receivables	2,378,959	2,686,628
Unbilled receivables	1,788,585	1,324,901
	4,167,544	4,011,529
Allowance for doubtful debts (Refer to Note 23)	(543,910)	(877,967)
	3,623,634	3,133,562

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

(Thousands of Saudi Riyals)

	2005	2004
Balance at January 1	877,967	756,462
Additions	272,393	653,152
	1,150,360	1,409,614
Bad debts written-off	(606,450)	(531,647)
Balance at December 31	543,910	877,967

(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 concerned parties on the collection of these revenues. Total uncollected revenues from such customers for the year 2005 amounted to SR 156 million (2004: SR 179 million), with an annual average of SR 230 million for the six years preceding 2005.

(c) The Company has agreements with foreign network operators whereby amounts receivable from and payable to the same foreign network operator are subject to netting. At December 31, 2005 and 2004, the net amounts included in accounts receivable and accounts payable were as follows:

(Thousands of Saudi Riyals)

	2005	2004
International accounts receivable, net	484,033	627,354
International accounts payable, net	755,530	755,894

(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 year was as follows:

(Thousands of Saudi Riyals)

	2005	2004
Balance at January 1	230,473	324,042
Additions	323,512	388,251
Usage	(390,241)	(481,820)
	163,744	230,473
Inventory allowance	(10,456)	(12,823)
Balance at December 31	153,288	217,650

7 PREPAYMENTS AND OTHER CURRENT ASSETS

Prepayments and other current assets consisted of the following:

(Thousands of Saudi Riyals)

	2005	2004
Frequency evacuation project	191,671	44,594
Advances to suppliers	65,164	36,158
Deferred costs	59,871	41,005
Prepaid rent	53,400	31,120
Prepaid insurance	20,229	21,495
Other	83,066	22,179
	473,401	196,551

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 payable by the Government have been appropriated and are reflected under "Other payables". (Refer to Note 15).

Included in "Other" in 2005 is an amount of SR 31.7 million which represents the current portion of the employees' housing loans. (Refer to Note 12).

8 PROPERTY, PLANT AND EQUIPMENT, NET

(Thousands of Saudi Riyals)	Land and Buildings	Telecommunications Plant and Equipment	Other Assets	Capital Work In Progress	Total 2005	Total 2004
Gross book value						
At January 1	9,401,006	44,637,631	1,008,485	2,121,007	57,168,129	56,590,138
Additions	75,650	817,674	125,780	3,370,040	4,389,144	3,749,656
Transfers	30,122	1,917,893	-	(1,948,015)	-	-
Disposals	(24,905)	(2,123,907)	(44,734)	-	(2,193,546)	(3,171,665)
At December 31	9,481,873	45,249,291	1,089,531	3,543,032	59,363,727	57,168,129
At January 1	3,729,821	21,909,616	747,050	-	26,386,487	24,683,459
Charge for the year	167,272	3,546,494	122,445	-	3,836,211	4,261,391
Provision for capital work in progress	-	-	-	389,251	389,251	-
Disposals	(6,821)	(1,729,335)	(44,656)	-	(1,780,812)	(2,558,363)
At December 31	3,890,272	23,726,775	824,839	389,251	28,831,137	26,386,487
Net book value	5,591,601	21,522,516	264,692	3,153,781	30,532,590	30,781,642

(a) Land and buildings above include land of SR 2,299 million as of December 31, 2005 and 2004.

(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 lands is still in progress. Lands for which legal ownership has been transferred into the Company' name amounted to SR 1,667 million as of December 31, 2005. The transfer of the ownership of the remaining lands with a value of SR 632 million is still in progress.

(c) During the year, 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.

9 INTANGIBLE ASSETS

The amount reflected in the balance sheet represents the amount paid to the CITC for obtaining the license to provide the third generation (3G) mobile services, which was obtained on 27 Jumada Al Oula 1426H (July 4, 2005). This amount will be amortized in accordance with the requirements of the accounting standards.

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)	2005 Ownership	2005	2004 Ownership	2004
Arab Satellite Communications Organization ("Arabsat")	36.66%	846,633	36.66%	766,089
Arab Submarine Cables Company Ltd.	42.86%	45,371	41.43%	35,929
		892,004		802,018

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

11 OTHER INVESTMENTS

(a) Other investments consist of the following:

(Thousands of Saudi Riyals)

	2005	2004
Available for sale – at market value:		
Investment in New ICO	33	33
Available for sale – at cost:		
Investment in Intelsat Ltd.	-	55,649
Notes	100,000	-
	100,000	55,649
Held to maturity:		
Notes	-	100,000
Total other investments	100,033	155,682

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

(c) The balance of unrealized holding losses on investments reflected at market value amounted to SR 3.3 million at December 31, 2005 and 2004.

(d) 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. Commission earned from these notes during 2005 amounted to SR 4.4 million. The Company's Board of Directors has resolved in 2006 to sell these notes.

(e) During 2004, the Company sold its investment in Newskies for SR 26.7 million and realized a gain amounting to SR 3.1 million.

12 OTHER NON-CURRENT ASSETS

Other non-current assets consist of the following:

(Thousands of Saudi Riyals)

	2005	2004
Employee housing loans	441,362	-
Deferred costs	73,993	82,017
	515,355	82,017

Employee housing loans, bearing no commission, were granted to employees during 2005 in accordance with the approved policy and are stated at cost as of December 31, 2005.

13 ACCOUNTS PAYABLE

(a) Accounts payable consist of the following:

(Thousands of Saudi Riyals)

	2005	2004
Government charges	1,113,256	1,515,074
Capital expenditures	188,929	155,226
Trade	548,260	302,407
International settlements	755,530	755,894
	2,605,975	2,728,601

(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 related accounts payable balances are netted against international settlements related accounts receivable balances. (Refer to Note 5).

14 DIVIDENDS PAYABLE

Movement in dividends during the year was as follows:

(Thousands of Saudi Riyals)

	2005	2004
Balance at January 1	47,778	17,248
Approved distributions during the year:		
SR 7 per share for the third quarter 2005	2,100,000	-
SR 14 per share for the first half of 2005	4,200,000	-
SR 14 per share for the second half of 2004	4,200,000	-
SR 12 per share for the first half 2004	-	3,600,000
SR 14 per share for the second half of 2003	-	4,200,000
	10,547,778	7,817,248
Payments made during the year	(10,340,529)	(7,769,470)
Balance at December 31	207,249	47,778

15 OTHER PAYABLES

Other payables consist of the following:

(Thousands of Saudi Riyals)

	2005	2004
Supplier retentions	866,720	941,658
Settlement of seconded employees' entitlements	338,635	615,650
Provision for Zakat (Refer to Note 26)	284,325	233,640
Incentives and rewards	260,870	234,673
Frequency evacuation project (Refer to Note 7)	250,000	-
Withholding tax provision	121,016	43,186
Refundable customers' guarantee deposits	83,366	69,325
Manpower improvement program	47,428	580,446
Other	144,006	160,357
	2,396,366	2,878,935

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 was reconciled based on the actual number of employees who chose 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)

	2005	2004
Capital expenditures	1,963,930	432,102
Trade	202,418	423,772
Employee accruals	573,359	567,997
Land provision	176,157	156,245
	2,915,864	1,580,116

17 EMPLOYEES' END OF SERVICE BENEFITS

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

(Thousands of Saudi Riyals)

	2005	2004
Balance at January 1	1,643,410	1,575,953
Charges during the year	298,692	290,650
Settlements made during the year	(329,562)	(223,193)
Balance at December 31	1,612,540	1,643,410

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

The Company's capital amounts to (15,000,000,000) fifteen billion Saudi Riyals, which is fully paid and divided into (300,000,000) three hundred million shares at par value of (50) fifty Saudi Riyals each. As of December 31, 2005, the Government owned 70% of the Company's shares. (Refer to Note 34).

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 2005, the Company appropriated an amount of SR 1,245 million (2004: SR 931.4 million). The statutory reserve on December 31, 2005 amounted to SR 4,539 million (2004: SR 3,294 million) which represents 30% of share capital (2004: 22%).

20 OPERATING REVENUES

Operating revenues consist of the following:

(Thousands of Saudi Riyals)

	2005	**2004**
Usage charges	25,835,087	23,229,230
Subscription fees	4,725,254	5,099,491
Activation fees	582,700	680,293
Other	1,396,902	1,489,649
	32,539,943	30,498,663

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".

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 international access charges as reflected in the statement of income. The Government charges were calculated as follows:

(Thousands of Saudi Riyals)

	2005	**2004**
Commercial service provisioning	4,540,696	5,675,778
License fees	302,713	283,789
Frequency spectrum	331,913	200,000
	5,175,322	6,159,567

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

(a) Commercial Service Provisioning

For 2004; 20% of net revenue (as defined above).

For 2005 and thereafter; 15% of net revenue (as defined above), in accordance with the amendment as per the Council of Ministers' Resolution No. 155 dated 10 Jumada Awal 1425 H (June 28, 2004).

(b) License Fees

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

(c) Frequency Spectrum

This was a fixed charge of SR 200 million per annum, and was applied for 2004. However, the Council of Ministers' Resolution No. 200 dated 7 Rajab 1425 H approved the pricing list for the frequency spectrum usage effective 90 days from the date of publication in the official newspaper. The application date corresponded to 25 Dhul Quada 1425 H (January 6, 2005). The new method of calculating the charge depends on various factors, the most important of which being the locations and widths of required frequencies, distances covered and technologies applied.

22 EMPLOYEE COSTS

Employee costs consist of the following:

(Thousands of Saudi Riyals)

	2005	2004
Salaries and allowances	2,819,381	2,821,176
End of service benefits	298,692	290,650
Incentives and rewards	279,201	230,527
Social insurance	234,608	234,382
Medical insurance	150,376	160,608
Other	100,825	72,436
	3,883,083	3,809,779

23 ADMINISTRATIVE AND MARKETING EXPENSES

Administrative and marketing expenses consist of the following:

(Thousands of Saudi Riyals)

	2005	2004
Sales commissions and advertising expenses	835,603	661,124
Doubtful debts expense	272,393	653,152
Printing of telephone cards and stationery	199,302	155,786
Utilities	167,901	144,955
Rent of equipment, property and motor vehicles	116,787	113,325
Consultancy	111,388	164,902
Training	87,296	57,424
Safety expenses	78,334	74,826
Other	271,777	62,718
	2,140,781	2,088,212

During 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.

24 COST OF MANPOWER IMPROVEMENT PROGRAM

The amount shown in the statement of income for 2005 represents the cost of implementing the fifth phase of the Company's manpower improvement program which was initiated during 2001. The number of employees covered by the fifth phase of this program was 817 employees. The following schedule shows the cost of each of the five phases:

(Thousands of Saudi Riyals)	Implementation Date	Cost
Phase I	2001	600,208
Phase II	2002	1,070,000
Phase III	2003	700,000
Phase IV	2004	580,008
Phase V	2005	519,903
Total		3,470,119

25 OTHER INCOME AND EXPENSES, NET

Other income and expenses consist of the following:

(Thousands of Saudi Riyals)	2005	2004
Miscellaneous revenue	311,239	115,230
Gains on sale of other investments	50,304	3,073
Provision for capital work in progress (Refer to Note 8-c)	(389,251)	-
Capitalized commission write-off (Refer to Note 8-c)	(304,184)	-
Losses on sale/ disposal of property, plant and equipment	(79,715)	(466,849)
Other, net	(5,387)	(78,617)
	(416,994)	(427,163)

26 ZAKAT

(a) Zakat base

(Thousands of Saudi Riyals)

	2005	**2004**
Share capital – beginning of the year	15,000,000	15,000,000
Additions:		
Retained earnings – beginning of the year	12,618,036	12,035,141
Statutory reserve – beginning of the year	3,293,882	2,362,449
Provisions – beginning of the year	2,967,270	2,742,063
Adjusted net income	11,689,956	9,338,851
Total additions	30,569,144	26,478,504
Deductions:		
Net property, plant & equipment, capital work in progress and intangible assets (limited to shareholders' equity before Zakat)	(31,286,340)	(30,781,642)
Dividends paid	(10,340,529)	(7,769,470)
Investments	(992,037)	(957,700)
Non-current deferred costs	(73,993)	(82,017)
Total deductions	(42,692,899)	(39,590,829)
Zakat base	2,876,245	1,887,675

Since the Zakat base is less than the adjusted net income, the Zakat rate of 2.5% is applied to adjusted net income to determine the Zakat charge.

(b) Zakat provision

(Thousands of Saudi Riyals)

	2005	**2004**
Balance at January 1	233,640	226,017
Amounts paid during the year	(241,564)	(245,133)
Charge for the year	292,249	252,756
Balance at December 31	284,325	233,640

Final zakat assessments have been approved for the years since inception through 2003. The final zakat assessment for 2004 has not yet been approved. The Company has received a Zakat Certificate which is valid up to 15 Safar 1427 H (March 15, 2006).

27 BORROWINGS

The Company has renewable short-term facilities with local banks, with varying maturities spreading to November 3, 2006, and commission rates equivalent to the Saudi Inter-Bank Offered Rate (SIBOR) plus 0.45% - 0.55% per annum. One of these facility agreements has been converted to an Islamic form "Tawarroq".

During the second quarter of 2004, SR 1,800 million were drawn from the short-term facilities, and the whole amount was repaid before the end of the second quarter of 2004.

The movement in borrowings during the year was as follows:

(Thousands of Saudi Riyals)

	2005	2004
Balance at January 1	-	-
Drawings during the year	-	1,800,000
Repayments during the year	-	(1,800,000)
Balance at December 31	-	-

28 RELATED PARTY TRANSACTIONS

Government entities

The Company provides various voice, data and other services to the Government.

Revenues and expenses related to Government entities in 2005 (including Government charges discussed in Note 21 above) amounted to SR 673 million and SR 5,361 million, respectively (2004: SR 928 million and SR 6,363 million, respectively).

Amounts payable to Government entities at December 31, 2005 totaled SR 1,255 million (2004: SR 1,634 million). Amounts receivable from Government entities at December 31, 2005 and 2004 are not material due to the settlement referred to in Note (5-d).

Investments accounted for under the equity method

During the year, the Company incurred charges of approximately SR 14 million in favour of Arabsat with respect to satellite utilization (2004: SR 19 million), while expenses incurred in favour of the Arab Submarine Cables Co. approximated SR 6 million (2004: SR 7 million).

29 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 367 million on December 31, 2005 (2004: SR 2,420 million).

(b) Land and buildings, for use in the Company’s operations, are leased under operating lease commitments expiring at various future dates. During 2005, total rent expense under operating leases amounted to SR 96 million (2004: SR 90 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 financial statements.

30 FINANCIAL INSTRUMENTS

Fair value

The carrying values of all financial instruments approximate their fair values at December 31, 2005 and 2004, 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, 2005. 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 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.

31 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 . The Company has commenced identifying and restructuring its operating segments in ways that accomplish the best efficiency levels in light of the developments in regulating the telecommunications sector by the CITC, which have recently accelerated resulting in important changes in the identification and segmentation of telecom services. The latest development was segregating the data and V-SAT as separate services having their own regulations.

The Company has achieved a level of progress in this regard despite the long time usually required for the completion of these types of operations and the resulting significant systems changes, due to the complexity of telecom services, particularly the interconnections between these services, which constitute an important part of the requirements to identify revenues, expenses and assets of each segment to properly evaluate its performance.

32 REDUCTION IN SERVICE RATES

In July 2005, the Company announced further reductions in the rates of international calls, in addition to what was announced in October 2004 of comprehensive varying rate reductions for mobile, fixed line, internet and leased circuits services, and the end of 2004 reductions in the rates of international calls.

33 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 and it is taking all necessary actions to preserve its rights.

34 SUBSEQUENT EVENTS

The Board of Directors, in its meeting of 28 Dhul Hijja 1426 H (January 28, 2006), proposed increasing the Company's share capital from SR 15 billion to SR 20 billion through stock dividends of one bonus share for each three outstanding shares, with a total value of SR 5 billion to be transferred from the retained earnings. The legal formalities relating to the increase of the Company's share capital will be completed after approval by the Company's general assembly in its upcoming extraordinary meeting.

The Board of Directors has also proposed distribution of cash dividends of SR 10 per share for the fourth quarter of 2005, resulting in a total dividend for 2005 of SR 31 per share.

35 RECLASSIFICATION

Certain 2004 numbers have been reclassified to conform to the 2005 numbers classifications.

36 INTERIM FINACIAL STATEMENTS (UNAUDITED)

Following are the quarterly income statements:

(Thousands of Saudi Riyals)	**First Quarter**		**Second Quarter**		**Third Quarter**		**Fourth Quarter**	
	2005	**2004**	**2005**	**2004**	**2005**	**2004**	**2005**	**2004**
Total operating revenues	7,918,233	7,321,043	8,038,267	7,564,963	8,105,095	7,852,766	8,478,348	7,759,891
Total operating expenses	(4,605,797)	(4,771,068)	(5,115,826)	(4,885,664)	(4,389,410)	(5,176,979)	(5,066,857)	(5,185,226)
Operating income	**3,312,436**	**2,549,975**	**2,922,441**	**2,679,299**	**3,715,685**	**2,675,787**	**3,411,491**	**2,574,665**
Other income and expenses								
Cost of manpower improvement program	(352,456)	(37,500)	(56,048)	(37,500)	(55,700)	(37,500)	(55,699)	(467,508)
Commissions	41,391	17,100	41,153	8,974	51,100	11,531	73,630	25,763
Earnings of investments accounted for under the equity method	18,665	19,102	39,023	15,170	615	23,358	48,377	(26,469)
Other, net	60,767	(4,271)	24,610	46,695	(377,342)	(78,806)	(125,029)	(390,781)
Net income before zakat	**3,080,803**	**2,544,406**	**2,971,179**	**2,712,638**	**3,334,358**	**2,594,370**	**3,352,770**	**1,715,670**
Provision for zakat	(69,851)	(41,772)	(68,041)	(74,334)	(72,364)	(68,127)	(81,993)	(68,523)
Net income	**3,010,952**	**2,502,634**	**2,903,138**	**2,638,304**	**3,261,994**	**2,526,243**	**3,270,777**	**1,647,147**
Earnings per share in Saudi Riyals	10.04	8.34	9.68	8.79	10.87	8.42	10.90	5.49