



a Saudi Joint Stock Company

Interim Financial Statements for the Second Quarter 2003

**(Interim Financial Statements for the
Three and Six Months Ended June 30, 2003 (Unaudited))**

Saudi Telecom Company
(a Saudi Joint Stock Company)
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Saudi Telecom Company
(a Saudi Joint Stock Company)
Auditors' Report

ACCOUNTANTS' REVIEW REPORT

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

We have reviewed the accompanying interim balance sheet of Saudi Telecom Company (a Saudi Joint Stock Company) as of June 30, 2003 and the related statements of income for the three month and six month periods ended June 30, 2003 and the statement of cash flows for the six month period then ended. We have neither audited nor reviewed the Company's financial statements for the three month and six month periods ended June 30, 2002. These interim financial statements are the responsibility of the Company's management and were presented to us with all the information and explanations which we requested.

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

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

Deloitte & Touche
Bakr Abulkhair & Co.

Bakr A. Abulkhair
(License No. 101)
Jamad Al Awal 17, 1424
July 17, 2003

Saudi Telecom Company
(a Saudi Joint Stock Company)
Interim Balance Sheet as of June 30, 2003 (Unaudited)

	<u>Notes</u>	<u>2003</u> <u>SR'000</u>	<u>2002</u> <u>SR'000</u>
<u>ASSETS</u>			
Cash and cash equivalents		4,310,228	2,643,854
Accounts receivable, net		2,469,432	6,262,366
Inventories, net		346,097	378,902
Prepayments and other current assets		<u>236,418</u>	<u>208,836</u>
Total current assets		7,362,175	9,493,958
Property, plant and equipment, net		32,434,090	30,776,425
Investment in associates	3	791,974	722,191
Other investments		111,353	126,907
Other non-current assets		<u>87,730</u>	<u>83,774</u>
Total assets		<u>40,787,322</u>	<u>41,203,255</u>
<u>LIABILITIES AND SHAREHOLDERS' EQUITY</u>			
Accounts payable		3,402,661	6,528,715
Accrued expenses and other payables		4,588,647	6,393,830
Deferred revenue - current		1,430,565	1,361,782
Short-term borrowings		<u>566,667</u>	<u>1,300,000</u>
Total current liabilities		9,988,540	15,584,327
Deferred revenue		1,530,297	1,945,132
Long-term borrowings		375,000	483,333
Employees' end of service benefits		<u>1,481,710</u>	<u>1,414,935</u>
Total liabilities		<u>13,375,547</u>	<u>19,427,727</u>
Shareholders' Equity			
Common shares:			
authorized, issued and outstanding shares:			
300,000,000 on June 30, 2003			
240,000,000 on June 30, 2002			
par value SR 50 per share	4	15,000,000	12,000,000
Legal reserve		1,924,714	1,285,903
Retained earnings	7	10,495,525	8,496,222
Unrealized losses on other investments		<u>(8,464)</u>	<u>(6,597)</u>
Total Shareholders' equity		<u>27,411,775</u>	<u>21,775,528</u>
Total liabilities and Shareholders' equity		<u>40,787,322</u>	<u>41,203,255</u>

The accompanying notes 1 to 8 form an integral part of these interim financial statements.

Saudi Telecom Company
(a Saudi Joint Stock Company)
Interim Statement of Income for the Three and Six Months Ended June 30, 2003
(Unaudited)
(Saudi Riyals in thousands)

	<u>Notes</u>	<u>Three Months ended</u> <u>June 30,</u> <u>2003</u> <u>2002</u>		<u>Six Months ended</u> <u>June 30,</u> <u>2003</u> <u>2002</u>	
Operating Revenues					
Wireline		2,200,447	2,929,366	4,607,496	5,854,689
Wireless		<u>4,102,389</u>	<u>2,913,726</u>	<u>8,400,850</u>	<u>5,396,084</u>
Total operating revenues		<u>6,302,836</u>	<u>5,843,092</u>	<u>13,008,346</u>	<u>11,250,773</u>
Operating Expenses					
Government charges	5	(1,284,244)	(1,564,134)	(2,648,120)	(2,999,603)
Access charges		(425,481)	(435,472)	(874,441)	(895,049)
Employee costs		(925,280)	(942,019)	(1,690,868)	(1,790,611)
Depreciation		(896,737)	(791,898)	(1,771,433)	(1,599,048)
General and administrative expenses		(518,147)	(548,384)	(1,151,459)	(1,035,234)
Repairs and maintenance		<u>(362,238)</u>	<u>(307,382)</u>	<u>(728,276)</u>	<u>(573,289)</u>
Total operating expenses		<u>(4,412,127)</u>	<u>(4,589,289)</u>	<u>(8,864,597)</u>	<u>(8,892,834)</u>
Operating Income		<u>1,890,709</u>	<u>1,253,803</u>	<u>4,143,749</u>	<u>2,357,939</u>
Other Income and Expenses					
Commission income		12,135	7,087	17,130	17,342
Earnings of investment in associates		(8,451)	26,602	22,340	55,040
Other, net		<u>45,146</u>	<u>(32,486)</u>	<u>68,445</u>	<u>(21,929)</u>
Other income and expenses, net		<u>48,830</u>	<u>1,203</u>	<u>107,915</u>	<u>50,453</u>
Net Income before Non-recurring Item and Zakat		<u>1,939,539</u>	<u>1,255,006</u>	<u>4,251,664</u>	<u>2,408,392</u>
Cost of early retirement program		<u>-</u>	<u>(1,070,000)</u>	<u>-</u>	<u>(1,070,000)</u>
Net Income before Zakat		1,939,539	185,006	4,251,664	1,338,392
Zakat		<u>(50,779)</u>	<u>-</u>	<u>(103,753)</u>	<u>(32,761)</u>
Net Income		<u>1,888,760</u>	<u>185,006</u>	<u>4,147,911</u>	<u>1,305,631</u>
Earnings per share	6	<u>SR 6.30</u>	<u>SR 0.62</u>	<u>SR 13.83</u>	<u>SR 4.35</u>

The accompanying notes 1 to 8 form an integral part of these interim financial statements.

Saudi Telecom Company
(a Saudi Joint Stock Company)
Interim Statement of Cash Flows for the Six Months Ended June 30, 2003 (Unaudited)
(Saudi Riyals in thousands)

	<u>2003</u>	<u>2002</u>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	4,147,911	1,305,631
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	1,771,433	1,599,048
Allowance for doubtful accounts	561,900	705,661
Loss on sale/disposal of property, plant and equipment	-	52,539
Undistributed earnings of investment in associate	(22,340)	(55,040)
Changes in:		
Accounts receivable	2,416,576	(891,797)
Inventories	64,558	68,642
Prepayments and other current assets	(110,038)	(111,518)
Other non-current assets	(1,664)	(11,860)
Accounts payable	(3,529,774)	119,414
Accrued expenses and other payables	497,536	1,617,735
Deferred revenue	(303,202)	21,510
Employees' end of service benefits	99,140	(13,410)
Net cash provided by operating activities	<u>5,592,036</u>	<u>4,406,555</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(2,187,279)	(2,557,538)
Capital distributions related to other investments	5,271	5,269
Net cash used in investing activities	<u>(2,182,008)</u>	<u>(2,552,269)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends paid	(750,000)	(896,114)
Repayments of long-term borrowings	(291,666)	(116,667)
Net cash used in financing activities	<u>(1,041,666)</u>	<u>(1,012,781)</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS	2,368,362	841,505
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	<u>1,941,866</u>	<u>1,802,349</u>
CASH AND CASH EQUIVALENTS AT END OF PERIOD	<u>4,310,228</u>	<u>2,643,854</u>

The accompanying notes 1 to 8 form an integral part of these interim financial statements.

Saudi Telecom Company
(a Saudi Joint Stock Company)
Notes to the Interim Financial Statements for the Three and Six Months Ended
June 30, 2003 (Unaudited)

1 DESCRIPTION OF BUSINESS, BACKGROUND AND BASIS OF PRESENTATION

a) Description of business

Saudi Telecom Company (the “Company”) is the sole entity engaged in the provision of telecommunications services in the Kingdom of Saudi Arabia (the “Kingdom”). The Company provides a range of telecommunications services including fixed local, national and international telephone services, telex, telegraph, data transmission, leased lines, public telephones and public network services. The Company also provides mobile and radio paging services in the Kingdom.

The Council of Ministers’ Resolution No. 171 dated 2 Rajab 1423H (corresponding to September 9, 2002), approved opening the telecommunications sector for competition by partially liberalizing the mobile services in the last quarter of 2004, and the landline services in 2008.

b) Corporate background

The Company was established by the Royal Decree No. M/ 35, dated 24 Dhul Hujja 1418H (corresponding to April 21, 1998) as a Saudi Joint Stock Company, in accordance with the Council of Ministers’ Resolution No. 213, dated 23 Dhul Hujja 1418H (corresponding to 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”), however, the Council of Ministers, in its capacity as the Company’s Extraordinary General Assembly, has issued the Resolution No. 171, referred to in (1- a) above, whereby it approved increasing the Company’s capital from (12,000,000,000), SR twelve billion, to (15,000,000,000), SR fifteen billion, by transferring a part of the Company’s retained earnings to share capital, and, also, to sell (30%), thirty percent, of the Government’s shares in the Company by offering at least (20%), twenty percent, to Saudi individuals and not more than (10%), ten percent, to both of the Public Pension Fund and the General Organization for Social Insurance, in equal proportions. The subscription period ended on 3 Dhul Quada 1423H (corresponding to January 6, 2003).

The Company received its commercial registration number 101050269 as a Saudi Joint Stock Company on 4 Rabi Awal 1419H (corresponding to June 29, 1998).

Prior to 6 Muharram 1419H (corresponding to May 2, 1998), the provision of public telecommunications services in the Kingdom was operated by the telegraph and telephone division of the MoPTT (hereinafter referred to as “Telecom Division”). Pursuant to Royal Decree No. M/35, the Telecom Division, with its various components and technical and administrative facilities, was transferred to the Company. A regulatory body, the Saudi Communications Commission, was formed on 5 Rabi Awal 1422H (corresponding to May 28, 2001) to regulate the telecommunications industry within the Kingdom.

The Company commenced its operations as Kingdom-wide provider of telecommunications services on 6 Muharram 1419H (corresponding to May 2, 1998) with the initial term of the Company being fifty years from the date of the Royal Decree. This term may be extended.

c) Period of the financial statements

In accordance with the Articles, the Company has fixed its financial year to begin on January 1 and end on December 31.

Saudi Telecom Company
(a Saudi Joint Stock Company)
Notes to the Interim Financial Statements for the Three and Six Months Ended
June 30, 2003 (Unaudited)

d) Preparation of the interim financial statements

The interim financial statements have been prepared in accordance with regulations and standards promulgated by the Saudi Organization for Certified Public Accountants, which functions under the auspices of the Ministry of Commerce.

e) Interim results

The results of operations for the interim period may not be a fair indication of the results of operations of the full year.

2 SIGNIFICANT ACCOUNTING POLICIES

The significant accounting policies adopted by the Company are summarized as follows:

a) Accounting convention

The interim financial statements are prepared under the historical cost convention, with the exception of property, plant and equipment transferred from the Telecom Division, as explained in note (g) below.

b) Use of estimates

The preparation of interim financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the interim financial statements and revenues and expenses during the interim financial statements period. Actual results could differ from those estimates.

c) Revenue recognition

Revenue is recognized when services are rendered based on the access to, or usage of, the exchange network and facilities. Usage revenues are based upon minutes of traffic processed. Charges billed in advance are deferred and recognized over the period the services are rendered. Unbilled revenue is recognized in the period to which it relates. Non-refundable up-front activation fees received from subscribers are deferred and recognized as revenue over the estimated service lives of the subscribers.

d) Financial instruments

Financial instruments include cash, investments, accounts receivable and payable, other receivables and payables and short and long-term borrowings. The Company does not currently use financial instruments that reduce exposure to fluctuations in foreign currency exchange and commission rates.

e) Cash and cash equivalents

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

f) Inventories

Inventories, which comprise principally cables 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 third parties responsible for upgrading and expanding the network are recorded within 'capital work in progress'.

Saudi Telecom Company
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June 30, 2003 (Unaudited)

g) Property, plant and equipment and depreciation

Prior to May 2, 1998, the Telecom Division did not maintain sufficiently detailed historical information to record property, plant and equipment based on the historical cost. Consequently, all property, plant and equipment transferred by the Telecom Division on May 2, 1998 has been included in these interim financial statements at a valuation which was performed by the Company with the assistance of independent international and local valuation experts. The following are the principal bases used for valuation:

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

Property, plant and equipment acquired by the Company after May 2, 1998 is recorded at historical cost.

Cost or valuation of the network comprises all expenditures up to the customer connection point. It also includes contractors' charges, materials and direct labor and commission costs, if any, up to the date the relevant assets are placed in service. Property, plant and equipment excluding land is depreciated using the straight line method over the following estimated useful lives:

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

A gain or loss resulting from the sale or disposal of property, plant and equipment are recognized in the interim statement of income. This represents the difference between the proceeds and the net carrying amount of the asset.

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.

h) Investment in associates

The Company accounts for investments in common stock in which it has at least 20% ownership under the equity method. Under the equity method, the Company recognizes in the interim statement of income its relative share of the investee's results of operations and adjusts the carrying amount of its investment to reflect its pro rata share of the net assets of the investee.

i) Other investments

Available for sale marketable securities are carried at fair value with unrealized holding gains and losses recorded as a separate component of shareholder's equity. Available for sale securities for which fair value cannot be reliably measured are recorded at cost, holding losses are charged to the interim statement of income, and the cost basis of the investment is decreased if it is determined by management that such losses are of an other than temporary nature. Gains and losses resulting from the sale of available for sale marketable securities are recognized in the interim statement of income and previous unrealized holding gains and losses on such securities are reversed.

Investments held to maturity (Government bonds) are reported at cost and adjusted for amortization of premiums and accretion of discounts, if any. Provisions are made for any permanent diminution in their value.

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June 30, 2003 (Unaudited)

j) Zakat

The Company is subject to Zakat in accordance with the regulations of the Department of Zakat and Income Tax. The Company calculates and records the Zakat provision within the interim financial statements. Adjustments arising from final Zakat assessments are recorded in the year in which such assessments are made.

k) Employees' end of service benefits

End of service termination benefits are payable as a lump sum to all employees employed under the terms and conditions of Saudi Labor and Workman Law upon termination of their employment contracts. The liability is calculated as the current value of the vested benefits to which the employee is entitled, should the employee leave at the interim balance sheet date. Termination payments are based on employees' final salaries and allowances and their cumulative years of service, as defined by the conditions stated in the laws of the Kingdom.

l) Foreign currency transactions

The Company maintains its financial records in Saudi Arabian Riyals (SR), the Company's functional currency, with transactions being recorded at the appropriate rate of exchange prevailing at the date of the transaction. Foreign currency receivables, payables and other monetary assets and liabilities are translated using rates of exchange prevailing at the interim balance sheet date. Exchange gains and losses arising on the settlement of foreign currency transactions and all unrealized gains and losses on foreign currency denominated monetary balances are recorded within the interim statement of income.

m) Government charges

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

n) Access charges

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

3 INVESTMENT IN ASSOCIATES

Two of the satellites of The Arab Satellites Communications Organization (Arabsat), in which the Company's stake amounts to 36.66%, have significantly been damaged. Claims have been raised to the insurance companies for compensation of the resulting loss. Arabsat expects that the compensation will cover a major part of the loss. It is not expected that the final settlement amount will have a material effect on the Company's financial statements.

4 INCREASE OF CAPITAL

In accordance with the Council of Ministers' Resolution No. 171, referred to in (1-a) above, it has been approved, during 2002, to increase the Company's capital by transferring SR 3,000 million from retained earnings. Consequently, the Company's capital amounted to SR 15,000 million, comprising 300 million shares at par value of SR 50 per share.

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Notes to the Interim Financial Statements for the Three and Six Months Ended
June 30, 2003 (Unaudited)

5 GOVERNMENT CHARGES

The Company is charged by the Government for the right to operate as the Kingdom-wide provider of telecommunications services based on net revenues. Net revenues is defined as total operating revenues less access charges as reflected in the interim statement of income. Effective from January 1, 1999, the Government charge is determined as follows:

- Commercial Provisioning

For 1999, 2000 and 2001; 20% of the net revenues (as defined above).

For 2002; 27% of the net revenues (as defined above).

For 2003 and thereafter; 20% of the net revenues (as defined above), in accordance with the amendment per the Council of Ministers' Resolution No. 171 referred to in (1-a) above. The Resolution stipulates that reduction in the percentage will be considered after opening the telecommunications sector for competition.

- License Fees

License fees will be determined as 1% of net revenues (as defined above). A portion of this fee will be used to finance the operations of the Saudi Communications Commission.

- Frequency Spectrum

A fixed fee of SR 200 million per annum. This fee will continue until such time that the Saudi Communications Commission establishes new telecom regulations.

The charges for the three and the six months ended June 30, 2003 are calculated as follows:

	<u>Three Months ended</u>		<u>Six months ended</u>	
	<u>June 30,</u>		<u>June 30,</u>	
	<u>2003</u>	<u>2002</u>	<u>2003</u>	<u>2002</u>
	SR 000's	SR 000's	SR 000's	SR 000's
Commercial Provisioning	1,175,471	1,460,058	2,426,781	2,796,046
License Fees	58,773	54,076	121,339	103,557
Frequency Spectrum	<u>50,000</u>	<u>50,000</u>	<u>100,000</u>	<u>100,000</u>
	<u>1,284,244</u>	<u>1,564,134</u>	<u>2,648,120</u>	<u>2,999,603</u>

6 EARNINGS PER SHARE

Basic earnings per share have been calculated by dividing net income for the period by the number of issued and outstanding shares as of June 30, 2003.

7 DIVIDENDS

On April 12, 2003 the Board of Directors, in its capacity as the Ordinary General Assembly of the Company, approved the distribution of dividends amounting to SR 750 million, being 5% of the paid-up capital. These dividends were paid in the second quarter 2003 to the shareholder outstanding on December 31, 2002.

Likewise, the Board of Directors approved on July 17, 2003 the distribution of semi-annual dividends of SR 8.00 per share for the period of six months ended June 30, 2003.

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Notes to the Interim Financial Statements for the Three and Six Months Ended
June 30, 2003 (Unaudited)

8 REDUCTION IN SERVICES RATES

The concerned parties have approved the proposal raised by the Company's Board of Directors for the reduction of service rates for some of its services. These reductions took effect on different dates during 2003, the latest being on April 1, 2003.