King Abdul Aziz Al Saud
Founder of the Kingdom of Saudi Arabia

King Abdullah Bin Abdul Aziz Al Saud
Custodian of the Two Holy Mosques

Prince Sultan Bin Abdul Aziz Al Saud
The Crown Prince, Deputy Premier
Minister of Defence and Aviation
and Inspector General

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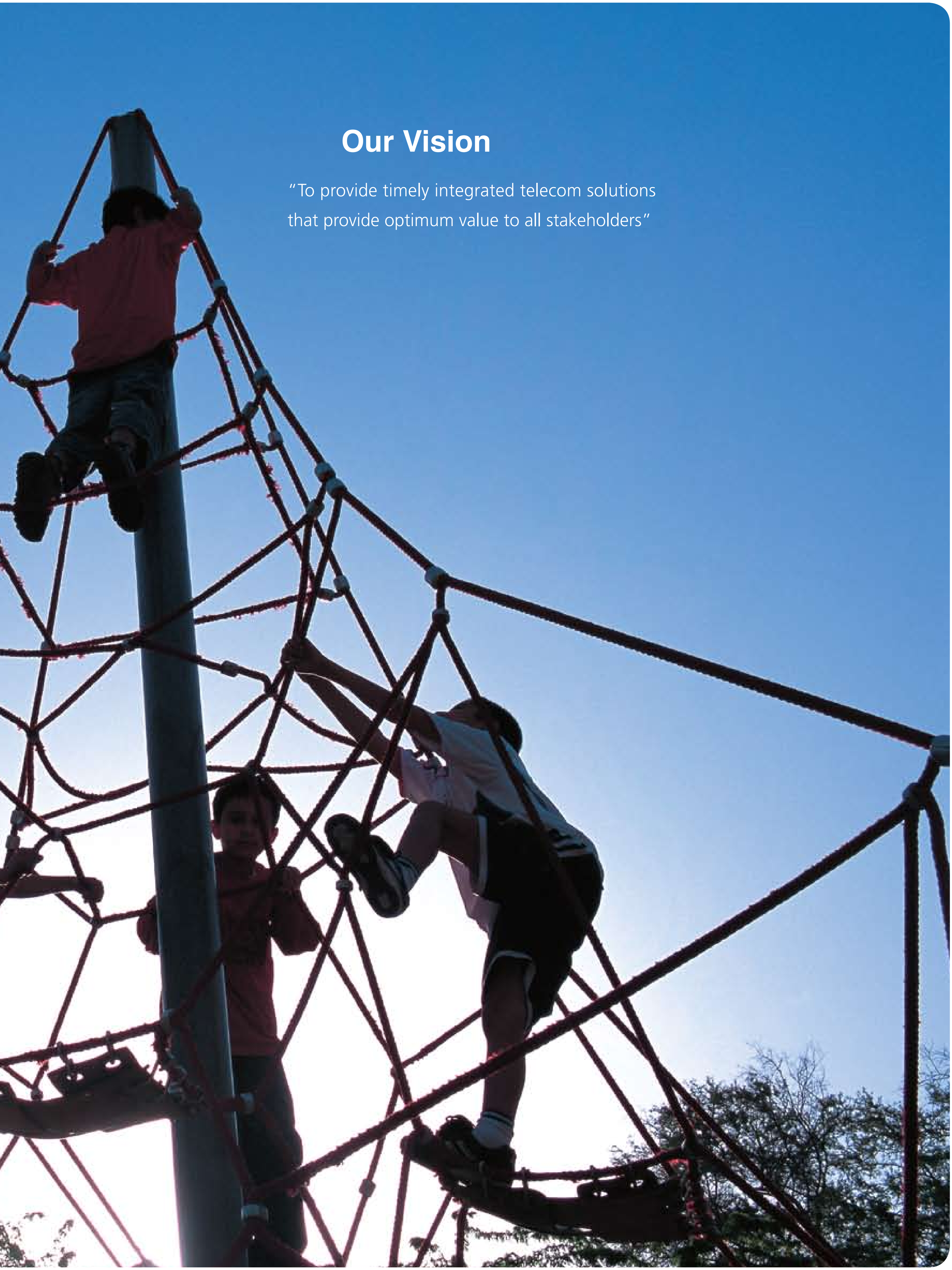
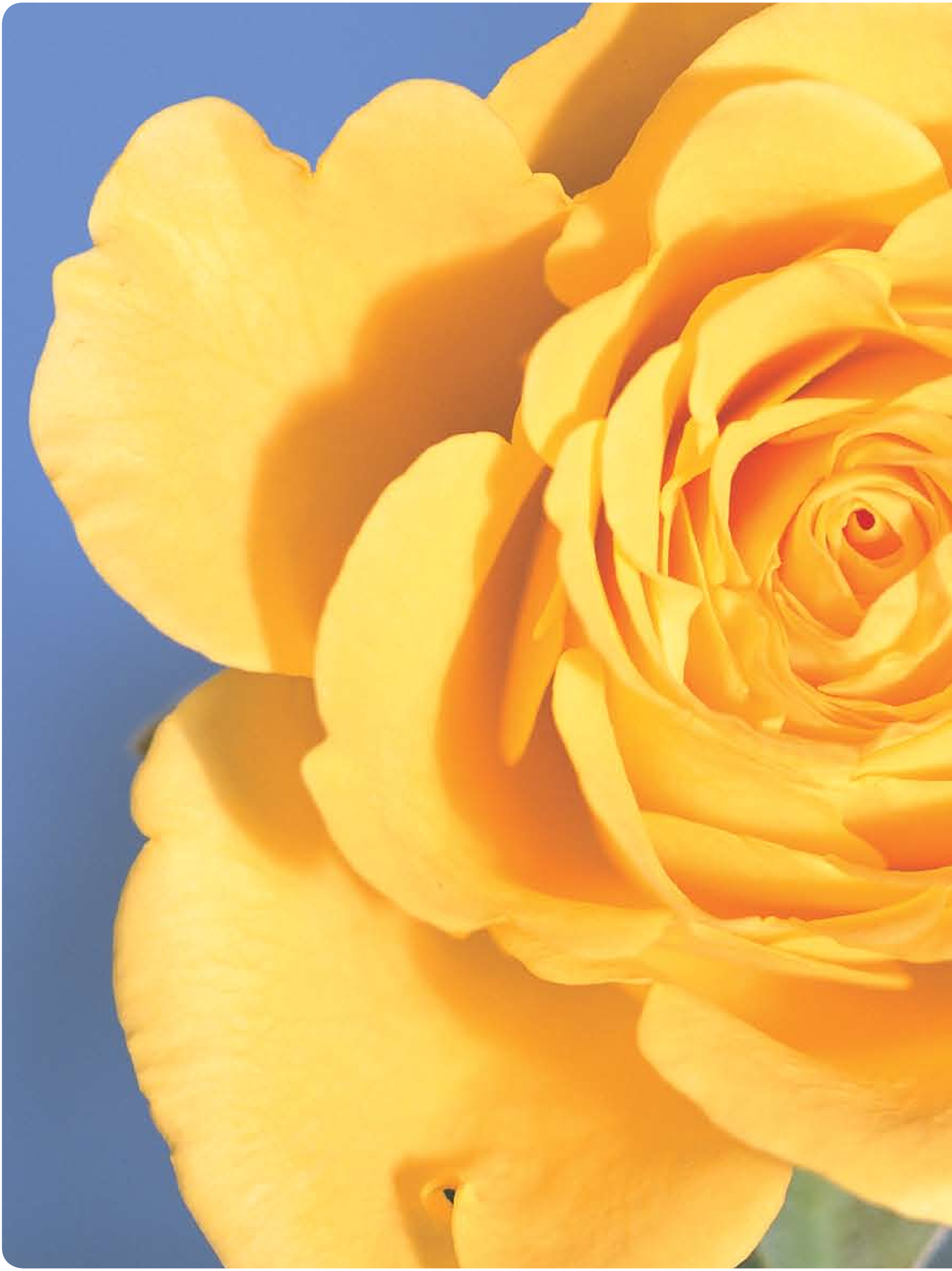
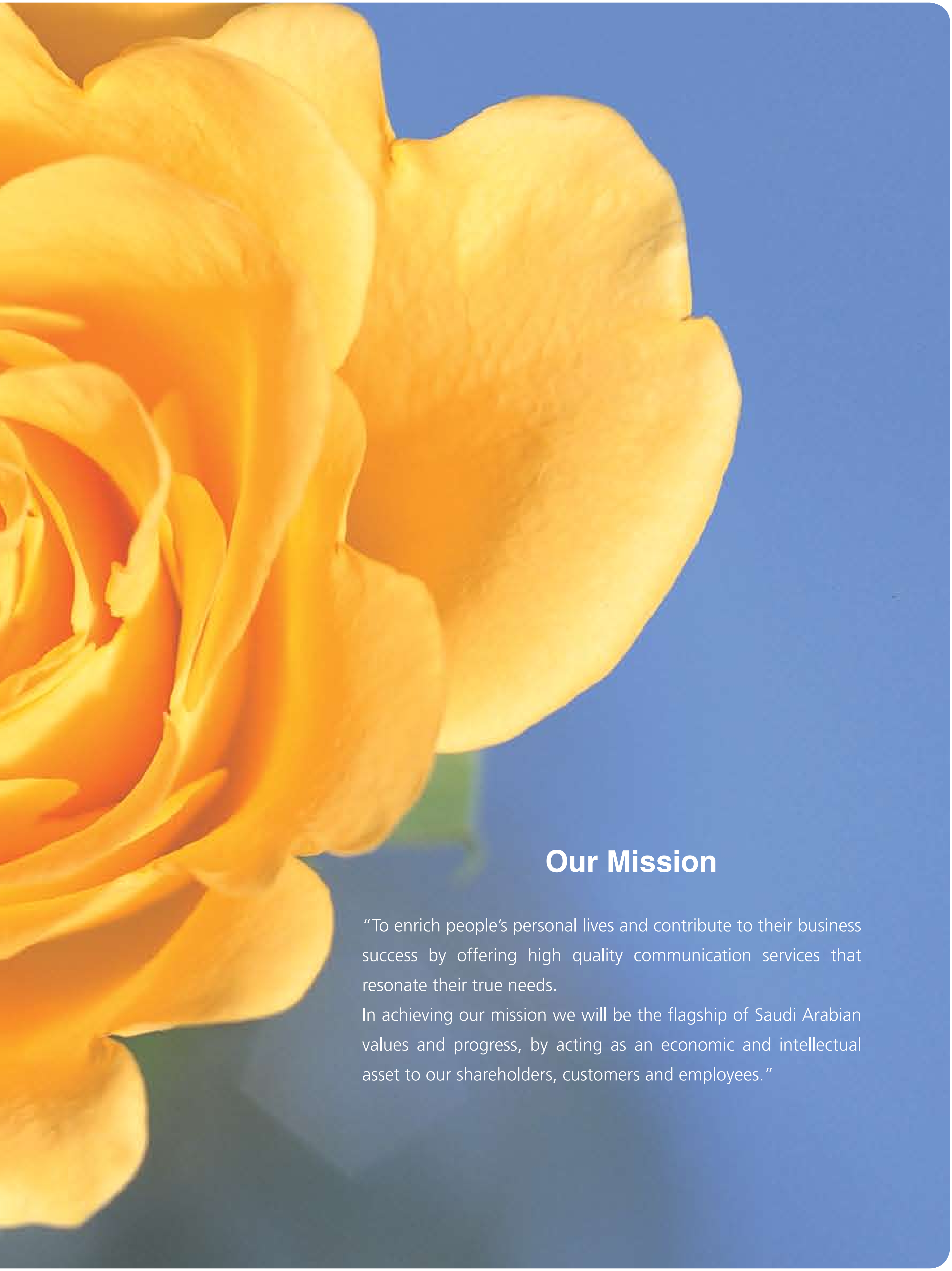
Our Vision

"To provide timely integrated telecom solutions that provide optimum value to all stakeholders"







Our Mission

"To enrich people's personal lives and contribute to their business success by offering high quality communication services that resonate their true needs.

In achieving our mission we will be the flagship of Saudi Arabian values and progress, by acting as an economic and intellectual asset to our shareholders, customers and employees."

Chairman's statement

Dear STC Shareholders,

Assalamu Alaykum,

3,95%
increase in
shareholder stakes

STC continued to maintain its strong financial position during 2006 which is directly and positively reflected on the shareholders dues and increase them by 3.95% during that year although the distributed dividend also increased. The Company has fulfilled the requirements of the governance regulations bylaw issued by the capital market authority of Saudi Arabia.

The STC 2006 Annual Report reflects briefly on this years achievements and their associated contribution to the development of Kingdom's telecom sector and national economic growth, particularly in light of the strategy adopted by the Company to cope with the growing competitive environment in the Saudi telecom sector and to strengthen its pioneer and leading position in this vital field.

61,223
billion Riyals
contribution to GNP

STC continued its commitment to contribute to the gross national product an amount of SR 61,223 billion, which consist of the government share of the annual profits and the government fees paid. These amounts do not include the value contributed to the national economy in terms of employee salaries and local purchases issued by the Company.

STC does not neglect its national and social roles. It has launched various initiatives for the preparations undertaken to apply the e-government project.

STC, in continuation of its significant national role since its foundation, has again succeeded this year to provide the pilgrims with high quality services. ALJAWAL network during the 1427 Hajj successfully and smoothly completed the pilgrims' calls. Innovative solutions were applied. Praise be to Allah the Company achieved record numbers of incoming and outgoing calls during Altarwiyah and Arafah days, Muzdalifah night and the first day of Eid. The calls placed by ALJAWAL network customers in the Holy places reached about 88 million in addition to 300 million SMS, 230 million international calls were completed successfully via STC network to all countries, particularly Arab and Muslim countries.

On another note, STC is very proud of its pioneering national social role and interaction with the community.

STC launched its unique national initiative "Alwafa'a Health Program", with a donation of SR 100 million to build and equip 28 primary health care centers Kingdom-wide. Also the "Alwafa'a Sports Program" was launched during this year to support sports activities and national clubs.

100

million Riyals donated to the Alwafa'a program

In continuation of its ongoing contribution to the Saudi economy and technological development STC has concluded an agreement for the establishment of an advanced international center for the MPLS data services in KSA. Upon completion of this important international center, STC shall enter proudly a new era of data services and enable its customers to smoothly access and utalize data services world-wide.

STC has been awarded **ISO/IEC 27001** certification for successful implementation of the international standard for Information Security Management Systems.

Finally and with our pride in the STC mission "to enrich people's personal lives and contribute to their business success by offering high quality communication services", it honors me to thank, in my name and on behalf of the Board of Directors members, the Government of the Custodian Of The Two Holy Mosques and H.R.H. The Crown Prince for their kind support and sponsorship of STC. Our thanks are also extended to the Ministry of Communication & Information Technology and CITC for their contribution to the development of the Kingdom's telecom sector, and STC shareholders for their trust and all STC staff for their outstanding efforts and achievements. We promise all of you that STC shall continue to lead Saudi Arabia in the field of telecom services.

Best Regards
Dr. Muhammad Sulaiman Al-Jasser
Chairman – STC Board of Directors

CEO's statement

Esteemed Shareholders & Customers of STC

Peace, Mercy and Blessings of Allah be upon you

2,8%
Growth in
net income

STC has continued to accomplish a distinct growth in volume of its works as well as growth of financial results. Within 2006, operational revenues have risen to reach SR 33,786 billion, achieving a growth of 3.8% higher than the year 2005 revenue despite the reduction in prices of services provided to customers. The Company has also achieved 2.8% growth in net income.

As a pioneering company in the field of telecommunications and to achieve its future objectives, STC has focused its future strategies on customer-centered aspects dealing with development of the international telecom sector in general and on the development of the Saudi market in particular. Accordingly, comprehensive work has commenced on seven critical core points of focus for the purpose of achieving the future strategic plan of Company named as **FORWARD**. These seven core points are: fulfill mobile potential, offer wholesale services, reinvent home communication, win enterprise customers, achieve external growth, reorganize internal structure and derive operational efficiency.

On the other hand, during 2006 the Company has accomplished many achievements, such as:

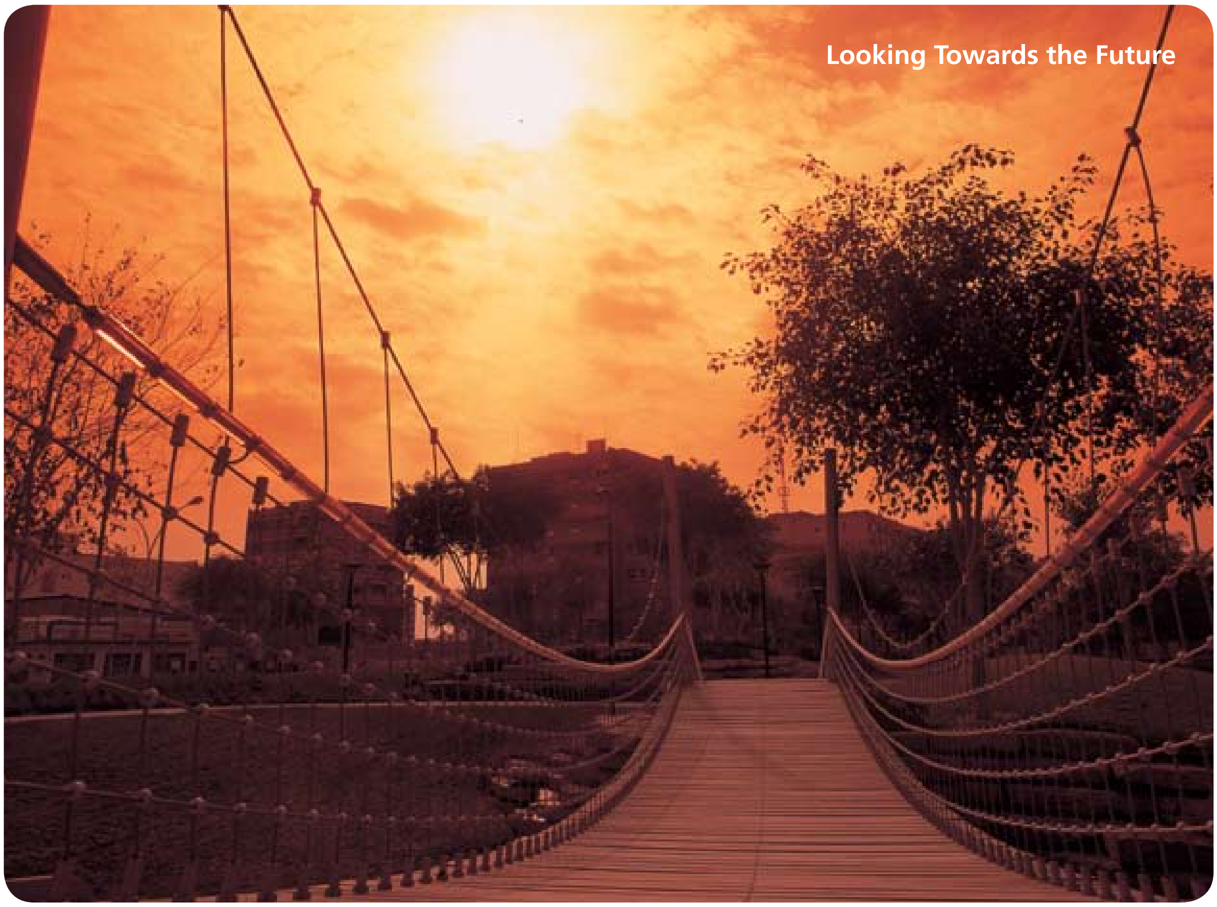
- As the first provider of mobile services in the Kingdom, STC has successfully launched high speed **3.5G** data services. STC has continued to provide new services that meet our customers' expectations in ALJAWAL, ALHATIF, and Saudi Data. During the year STC has continuesly reviewed its service prices so as to maintain its excellent competitive position.
- As part of its strategic investment, STC has acquired 50% of total paid capital of Tijari Saudi Company.
- Accomplished the largest project for extending **DSL** service for the provisioning of broad band services.
- According to the supreme resolution of the Ministers' Cabinet to restructure internet services in the Kingdom, STC has erected a second International Internet Gateway in Riyadh, after transferring the existing Internet gateway from King Abdulaziz city for Sciences & Technology to the company to support international gateway in Jeddah.
- In terms of financial classification internationally, STC has attained the 121st position among the 500 major international companies with respect to market value, improving 67 positions from the second quarter of 2006.
- According to the "Financial Times" report, STC has moved from eleventh place to occupy the eighth position among major international fixed-line phone service providers. In the same respect, STC now occupies the second position in Asia, only after Nippon Telegraph and Telephone in Japan.

- The Company won the Gulf Economic prize offered by Middle East Excellence Institute (Data Matix) in 2006.
- During 2006 the Company topped the list issued by Forbes Arab Magazine as the best company in the Arab world in terms of stock performance.
- The Company is proud of realizing 90% of Saudization. Additionally, the efforts of the Company in supporting its employees was quite fruitful and has led to the improvement of employee productivity compared to the previous year.

90%
Saudization in the company

Finally, I am honored, in my name and on behalf of all company employees, to thank our wise leadership for its continuous contribution in making STC one of the leading companies. I extend my thanks to the Ministry of Communication and Information Technology, and to CITC for their efforts and cooperation with us. Also, I seize this opportunity to thank their Excellencies, the Chairman and members of Board of Directors for their support to the executive management of the Company. Our thanks are also extended to our customers and shareholders for their confidence in STC, and to all the employees of the Company for their distinguished efforts which contributed to the international standing the Company has occupied. I hope that they will maintain this distinctiveness to realize our aspirations as a pioneering national company.

Regards
Eng. Saud Bin Majed Al Daweesh
The CEO



Dr. Muhammad bin Sulaiman Al-Jasser

Mr. Mohammad bin Abdullah Alkharashi

Mr. Mansour bin Mahmoud Abdulghafar

Mr. Mansour bin Salih Almeeman

Mr. Mohammed bin Saad Alshihri

Eng. Mohammed bin Umran Alumran

Mr. Abdulrahman bin Abdulaziz Mazi

Mr. Khalid bin Abdulrahman Alrajhi

Mr. Abdulaziz bin Habdan Alhabdan

Introduction

Board of Directors Report on STC Performance and Activities during the Fiscal Year 2006

STC Shareholders,

Assalmu Alaykum,

The Board of Directors have the pleasure to submit to you this brief annual report on STC performance and results for the fiscal year 2006. The report reflects the continuous development of STC performance in all aspects of the various activities of the Company and its role in the development of the telecommunications sector in the Kingdom of Saudi Arabia. In addition, the Company was able to better serve the Saudi community by effectively participating in the development of the national economy, as well as generating rewarding returns for its shareholders.

The STC strategy is based on the upgrading and expansion of its networks to provide the best telecommunications services to its customers in the field of ALJAWAL, ALHATIF, Saudi Data and Wholesale, focusing on the development of its employees' skills to provide innovative, distinct, high quality and efficient services that reflect the Company's position as the leader in this field. The Company recognizes the massive changes that have occurred due to the liberalization of the telecommunications market in the Kingdom, the entrance of new competitors and the Kingdom's accession to the WTO.
The Company continuously studies the competitive environment in all technical, organizational, human resources and financial aspects in order to react well to this new environment.

The following is a brief on the Company's management structure, activities, financial and technical performance during 2006.

1 Board of Directors:

BOD Members & Structure

Article No.(17) of the STC Articles of Association has limited the members of the Board of Directors to 9 members, in compliance with Paragraph A of Article No.12 of the Saudi Corporate Governance regulations issued by the Capital Market Authority decree No. 1-212-2006 dated 21/10/1427 H.
In the fiscal year 2006, a new Board of Directors was elected for the third session starting on 28/4/2006. The positions of the Chairman of the Board and CEO are completely separated as per the above-mentioned regulations. The following table includes the names of the members of the Board, thier classification and their memberships in other Saudi companies' Boards of Directors:

Serial Number	Name	Membership in other Boards of Directors	Membership type
1	Dr. Muhammad Sulaiman Al-Jasser Chairman and Head of the Executive Committee	• Arab Investment Co. (Chairman) • Saudi Arabian Mining Company (Maaden)	Non-executive - Not independent
2	Mohammad bin Abdullah Alkharashi Deputy Chairman, Head of Benefits & Compensations Committee and member of the Executive Committee	• National Cooperative Insurance Co. • Saudi Marketing and Research Group • Saudi Industrial Investments Group	Non-executive Independent
3	Mansour bin Mahmoud Abdulghafar Chairman – Head of Audit Committee	• Saudi Cables Co. • Saudi Lujain Co.	Non-executive Not independent
4	Mansour bin Salih Almeeman Member of the Executive Committee and Benefits & Compensations Committee	• South Region Cement Co. • Riyadh Bank	Non-executive Not independent
5	Mohammed bin Saad Alshihri - Member of the Executive Committee		Non-executive Not independent
6	Abdulaziz bin Habdan Alhabdan Member of Benefits & Compensations Committee	• Saudi Fransi Bank	Non-executive Independent
7	Eng. Mohammed bin Umran Alumran Member of the Executive Committee	• National Agricultural Development Co. "NADEC"	Non-executive Independent
8	Abdulrahman bin Abdulaziz Mazi Member of Benefits & Compensations Committee	• Technological Investments Co. (member of Board of Directors and Managing Director)	Non-executive Independent
9	Khalid bin Abdulrahman Alrajhi Member of the Audit Committee	• Saudi Cement • Albilad Bank	Non-executive Independent

Board Committees

The Board Committees for the 3rd session were formed as follows:

The Executive Committee

Consists of five members:
Dr. Muhammad Sulaiman Al-Jasser (Chairman), Muhammad bin Abdullah Alkharashi, Mansour bin Salih Almeeman, Muhammad bin Saad Alshihri , Eng. Muhammad bin Umran Alumran.
The committee is concerned with reviewing and approving the Company's strategies, national and international core and non-core businesses, pursuant to the authorities vested on it by the Board of Directors. The committee held four meetings during 2006.

Benefits & Compensations Committee

Consists of four members:
Muhammad bin Abdullah Alkharashi (Chairman), Mansour bin Salih Almeeman, Abdulrahman bin Abdulaziz Mazi, Abdulaziz bin Habdan Alhabdan.
The committee is concerned with the review and approval of the design of benifits and compensation model, developing structures in compliance with market criterias and the fair application of the same to provide management and employees with the required incentives to enable them to undertake their appropriate roles. The committee held eight meetings during 2006.

Audit Committee

Consists of four members:
Mansour bin Mahmoud Abdulghafar (Chairman), Khalid bin Abdulrahman Alrajhi, H.E. Abdulaziz bin Ibrahim Alumar, Dr. Ahmed bin Abdullah Almeghamis.
As per requirements of the corporate governance bylaws, all members of this committee are non-executives. The committee is concerned with reviewing the Company financial and administrative policies and procedures, preparation of financial reports and output procedures, internal audit reports, to evaluate the efficiency and effectiveness of the STC control activities and risk management. The committee held 13 meetings during 2006.

Members’ Participation in the Board Meetings & Committees

The Board of Directors held 18 meetings during the second session in 2006 that ended on 27/4/2006. The following Table shows the number of meetings held during the third session by the board and committees and the attendees.

Attendance of the Board of Directors members in Board and Committee meetings for the Period 28/4/2006 to 31/12/2006

Number of meetings / Members	Board of Directors	Executive Committee	Compensation & Benefits Committee	Audit Committee
	10	4	8	6
Dr. Muhammad Sulaiman Al-Jasser	10	4	-	-
Mohammed bin Abdullah Al-Kharashi	10	4	8	-
Mansour bin Saleh Al-Meeman	8	3	6	-
Mohammed bin Saad Al-Shehri	9	4	-	-
AbdulAziz bin Habdan Al-Habdan	7	-	-	6
Mansour bin Mahmoud AbdulGaffar	10	-	8	-
Mohammed bin Omran Al-O’mran	8	2	-	-
Abdulrahman bin abdulaziz Mazi	10	-	8	-
Khalid bin Abdulrahman Al-Rajhi	9	-	-	6

The absence of some members from the board and committees meetings is attributed to their being abroad.

It is worth mentioning that the Election and Regulation Committee was formed before the end of the second session of the previous Board of Directors. Its main objective was to ensure that the election of the Board is in compliance with the provisions of the Article of Association, the Company’s governance and all associated terms and regulations. This mission of the committee was completed by nomination to the third session.

The Company has adopted a well-documented disclosure policy identifying what, when and how to disclose data and identifying who is responsible for disclosures. This policy is available on the Company’s website. By doing so, the Company satisfies the governance guidelines set by the Market Authority in terms of committees’ formation, number of members and independency. The Company implemented the Corporate Governance Policy in February 2005, which covers most of CMA Governance Act released in 2006 that includes 31 articles in line with the internal and international regulations and provisions.

2 Financial Performance

The Company has achieved substantial growth in its business activities and revenues. The operation revenues amounted to SR 33,786 billion in 2006, a 3.8% increase over the previous year, despite the reduction of ALJAWAL services tariffs. This increase in revenues is attributable to the increase in the customer base and the international & domestic call traffic, which lead to 2.16% increase in ALJAWAL revenues, besides a decrease in operations revenues of (5.3%) coupled with (10.22%) as an increase of operational expenditure, compared to the same period last year. The ratio of operational expenditure to operation revenues by the end of 2006 was (62.6%) compared to (58.9%) for the same period in the previous year.

3,8%
growth in operational revenues

In 2006 the Company achieved a (2.8%) growth in net income. The dividends paid amounted to (SR 6.40) per share compared to (SR 6.22) for the same period last year, an increase of 2.8%. These achievements give the Company a strong financial position, reasonable cash flows and high profits that lead to an increase in shareholders gains that increased by 3.95% by the end of 2006. The Company is free from any debt in 2006.

Company's assets & Liabilities for the last years (SR in thousands)

Items	2002	2003	2004	2005	2006
Income balance	(SR in thousands)				
Operating revenues	23,547,065	27,292,018	30,498,663	32,539,943	33,785,889
Cost	(18,759,361)	(18,092,006)	(20,018,937)	(19,177,890)	(21,137,744)
Total profit	4,787,704	9,200,012	10,479,726	13,362,053	12,648145
General & Admin. Costs	(included with cost)				
Other income & expenses – Net	(1,149,620)	(448,589)	(912,642)	(622,943)	493,333
Zakat	(92,250)	(226,161)	(252,756)	(292,249)	(342,576)
Net Income	3,545,834	8,525,262	9,314,328	12,446,861	12,798,902
Financial Position List					
Current assets	7,926,809	8,883,638	10,296,468	11,950,144	13,362,282
Operating capital	(5,263,054)	(538,730)	1,737,227	2,495,413	3,838,819
Other long term assets	967,790	981,893	1,039,717	1,507,392	1,899,342
Fixed assets	32,018,244	31,906,679	30,781,642	31,286,340	30,860,149
Total assets	40,912,843	41,772,210	42,117,827	44,743,876	46,121,773
Liabilities	13,189,863	9,422,368	8,559,241	9,454,731	9,523,463
Long term loans	650,000	-	-	-	-
Other liabilities	3,063,650	2,955,204	2,650,010	2,433,708	2,443,971
Total liabilities	16,903,513	12,377,572	11,209,251	11,888,439	11,967,434
Paid capital	15,000,000	15,000,000	15,000,000	15,000,000	20,000,000
Reserves & profits	9,022,328	14,397,590	15,911,918	17,858,779	14,157,681
Owner equities	24,009,330	29,394,638	30,908,576	32,855,437	34,154,339
Total liabilities & owner equities	40,912,843	41,772,210	42,117,827	44,743,876	46,121,773

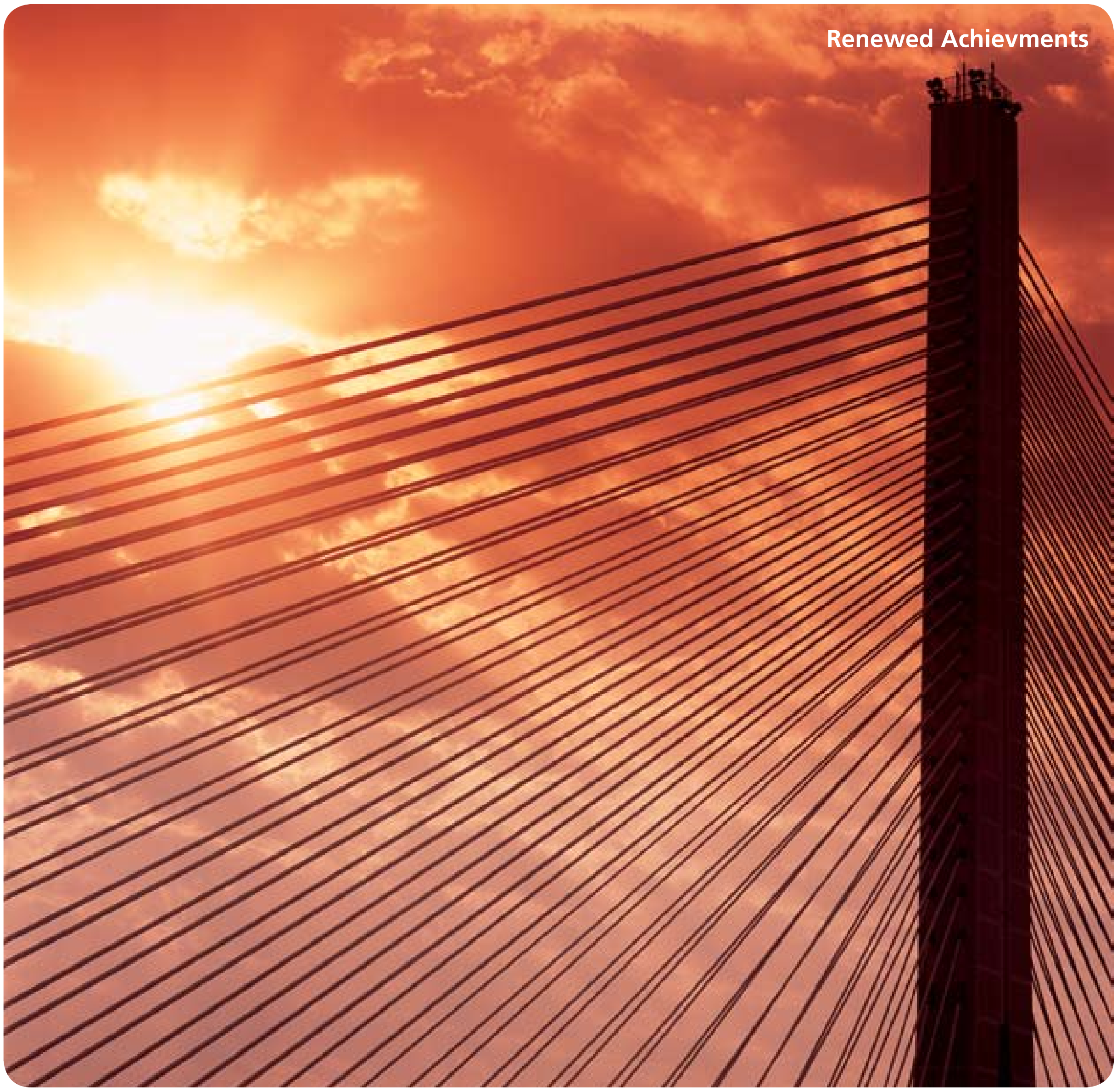
STC Organizational Structure

In view of the telecommunications sector deregulation, significant changes have emerged in the identification and segmentation of telecommunications services. As a result of competition requirements and the STC strategic goal to derive operational efficiency, the Company started restructuring its organization based on the customer segments (personal, enterprise, home and wholesale), which was approved by the Board of Directors in 2005. The new organization hopes to achieve the strategic plan objectives of the Company and the emerging technical and organizational requirements.

STC Subsidiaries

STC owns 50% (SR 28 million) of Saudi Tijari Company (LLC), established and operating in the local market. Tijari operations include establishing, operating and directing e-Markets, arranging auctions, providing solutions, application software and databases, website design, training and consultations related to e-commerce.

Mr. Abdulrahman A. Mazi, member of the STC Board, owns (10.83%) of Technical Consultations Firm, the second partner owning (40%) of Saudi Tijari Company, and (80%) of National IT Systems, the third partner in Saudi Tijari Company owning (10%). It is worth mentioning that the STC decision to become a partner of Saudi Tijari Company was made prior to the appointment of Mr. Abdulrahman A. Mazi as member of the current Board of Directors.



Payment of Royalties and Government Dues (SR in thousands)

Item	2005	2006	Description	Justifications
Zakat	292,249	342,576	Payable according to Zakat Regulations & Shariat Department requirements	Government requirement
GOSI	234,608	256,469	Payable according GOSI regulations	Government requirement
Government Charges (Royalty Fee)	5,175,322	4,446,169	Represents the cost of providing service, licenses and frerquency spectrum	Government requirement
Total official payments	5,702,179	5,045,214		

STC Dividends Distribution Policy

Distribution of dividends depends on the Company's income and cash flows, major investments forecasts and new capital investments with the objective of sustaining a strong financial position to respond to any major changes in the telecommunications market.

The Company usually pays high dividends in comparison to its net profits and cash flow.

Although the Company is keen to distribute profits annually, there is no guarantee of the amount of these dividends. The dividends distribution is subject to change from time to time and is paid in the currency of Saudi Riyals.

Internal Supervision

The Company's Board of Directors acknowledges that the financial statement is prepared in accordance with applicable accounting principles, and the Board has no doubt in the Company's ability to run and sustain its business.

With regard to the internal auditing, the Company is currently implementing STC corporate governance guidelines approved by the Board in 2005. The Audit Committee of the Board of Directors ensures that internal auditing is in place and performs efficiently.

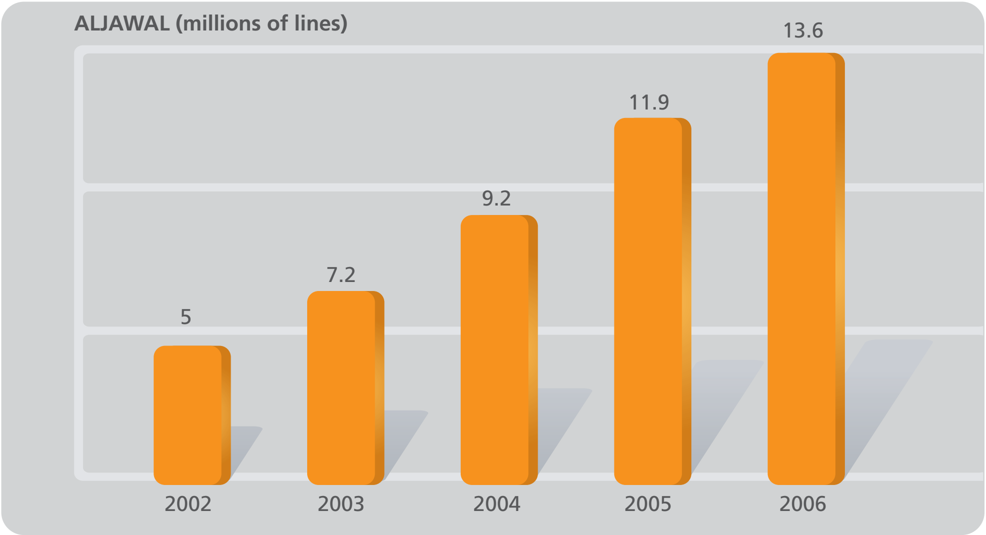
The Audit Committee is responsible for reviewing internal auditing reports at regular periods, to enable continuous assessment of auditing efficiency. This is in line with the Board's objective to be convinced of the sound design and efficiency of the internal auditing system, taking into consideration that any internal auditing system – regardless of its sound design and efficiency – can not provide absolute assurance.

Internal Audit

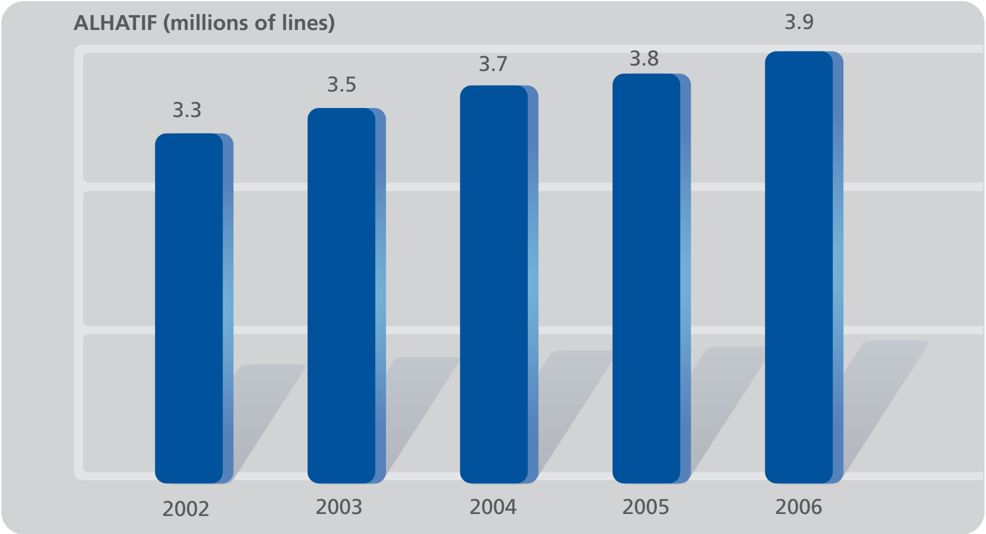
Internal auditing process is a reformative, objective, independent and consultative activity that aims to add value and improve the Company's operations. Internal auditing assists the organization to achieve its goals by providing a systematic approach to correct and improve risk management, control and monitoring of the Company's operations. Internal auditing has led many special and periodic audits which resulted in the elimination of revenue losses and achievement of cost reductions, as well as participated in the review of preliminary & final financial statements and the coordination external auditing work.

3 Customers & Services

The Company has achieved significant increases in customer lines in 2006 in mobile, fixed-line, DSL and data circuits:

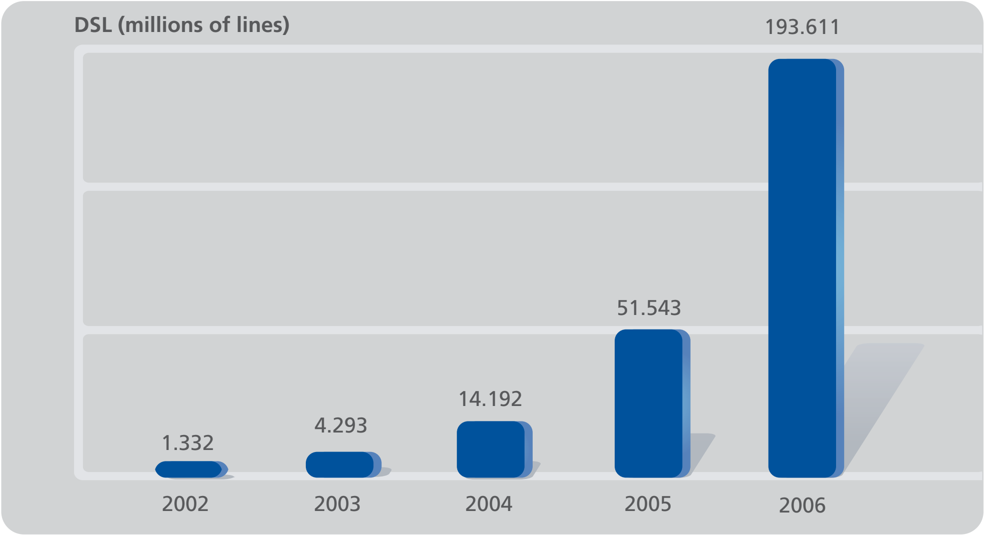


48%
increase in ALJAWAL lines through 2004 - 2006

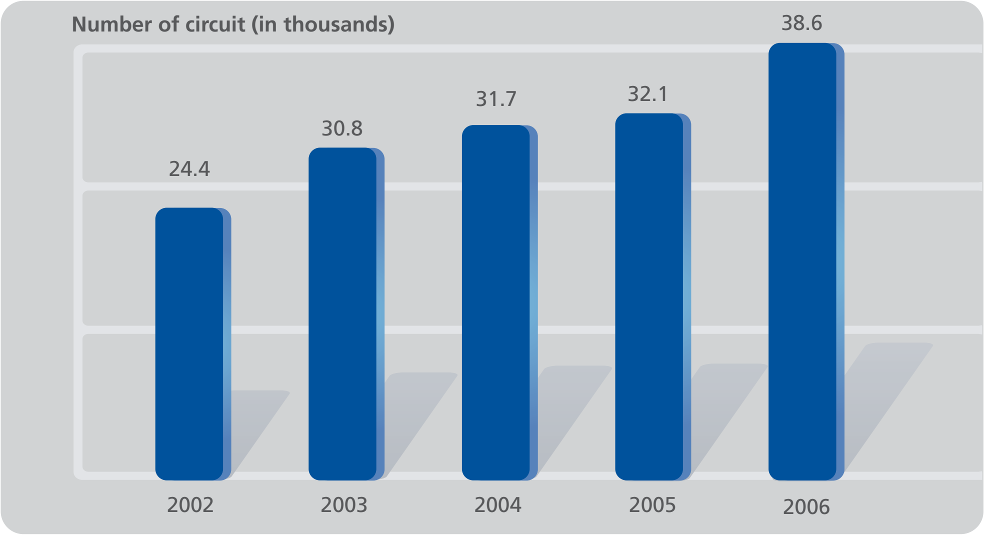


5%
increase in ALHATIF lines through 2004 - 2006

1264%
increase in DSL lines through 2004 - 2006



22%
increase in Data circuits through 2004 - 2006



- The number of interactive SMS increased from 76 million in 2005 to 304 million in 2006 an increase of 300%.
- The number of subscribers in the Qitaf loyalty program increased by188% from the previous year to reach 7,132,633.

Services:

STC continues to provide services to satisfy business units' customer requirements as follows:

ALJAWAL

(23) new services have been provided, (5) of them to serve the business sector and (18) to serve individuals, as follows:

A – Business Sector Services

- **Blackberry:** Blackberry is a wireless service that enables users to send & receive emails with Blackberry-enabled devices while they are away from their offices or laptops.
- **Business Mobile Service:** A reduced cost plan that allows the business sector to communicate with their companies at lower prices.
- **MVPN:** A service designed especially for companies and institutions. It links their private mobile numbers in a private network and allows them to communicate with each other via short numbers with a discount of 30% on calls tariffs.
- **Business Sector JAWALNet Service:** Enables customers to access the Internet at a competitive price.
- **Data SIM Service:** A mobile SIM used only to transfer and exchange information / data.

B – Personal Services

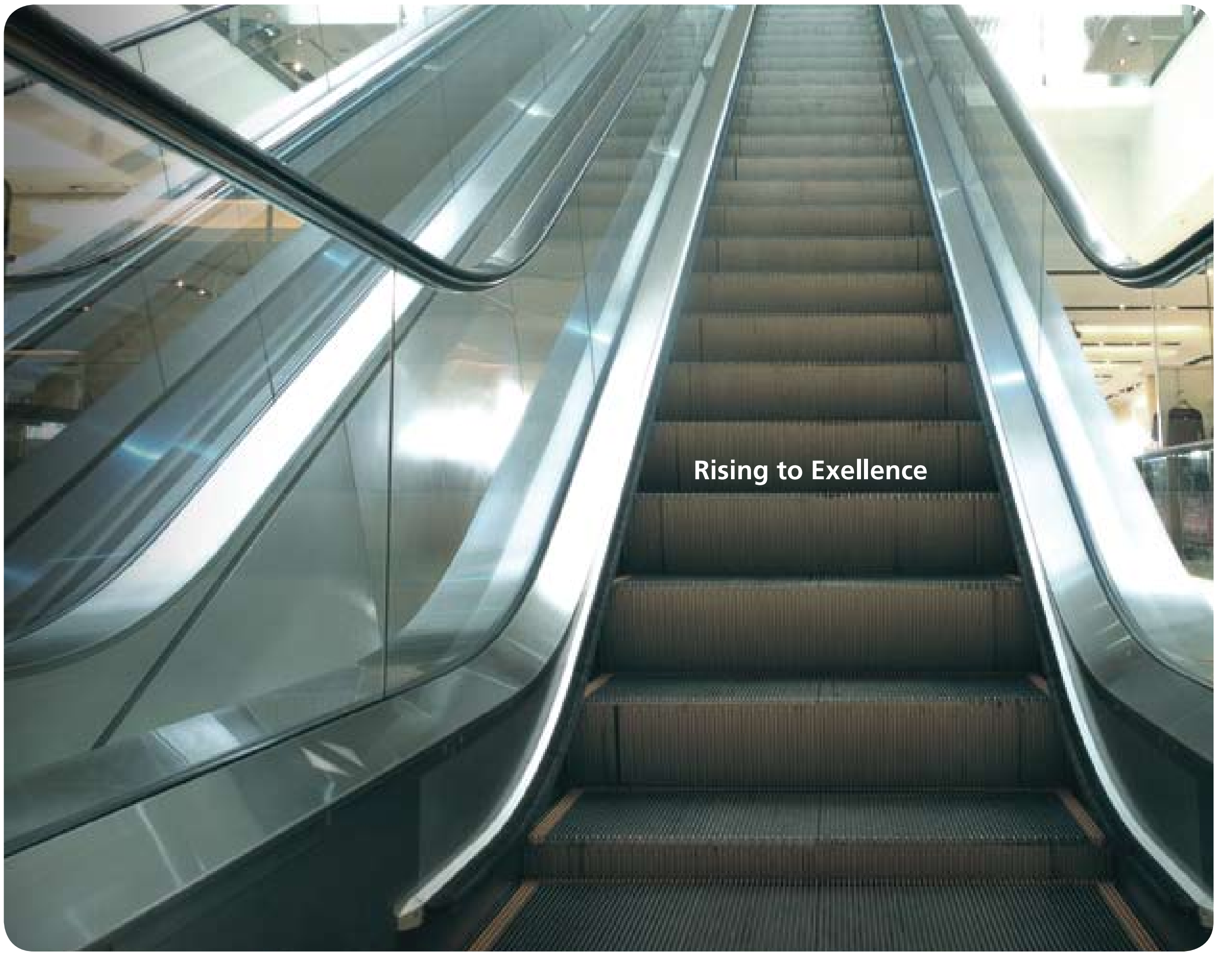
- **3G Service:** Enables customers to use video calling, live TV and access the Internet at high speeds up to 2 Mb/s.
- **Club Mobile Service:** Provides content services to sport clubs subscribers.
- **Multi-SIM Service:** Allows customers to use multiple SIMs for the same number.
- **Data Service through MMS:** Enables customers to get various information (news, economy, sports…etc) by using Multimedia Message Service (MMS) technology.
- **SAWA Electronic Recharging Service:** Enables SAWA card distributors to recharge SAWA for customers electronically.
- **MMS International:** Enables customers to send Multimedia Messages internationally.
- **Global Positioning System:** Enables ALJAWAL customers to determine service positions such as hospitals, hotels, shopping centres and restaurants as well as to determine the Qiblah direction.
- **ALJAWAL 25 Service:** A new package for ALJAWAL customers with monthly subscription charges of SR 25 and different call charges from the two current packages (ALJAWAL 35, ALJAWAL 45).
- **Mawjood Service for SAWA Customers.**
- **Jawal Net Service for SAWA Customers.**
- **Jawal Net Roaming Service:** Enables customers to use JawalNet to browse the Internet and e-mail while roaming internationally.
- **MMS Roaming:** Enables customers to use Multimedia (TX / RX) while roaming internationally.
- **Tamm Service:** Enables customers to enquire about the ownership of vehicles registered at the Traffic Department through Short Messages (SMS).
- **ALJAWAL Tadaul Service:** To get information about the capital market in a fast and easy way through Short Messages (SMS) and Multimedia Messages (MMS).
- **Budget Control Service:** Enables ALJAWAL customers to use SAWA recharge cards to credit their accounts with advance payments or for bill settlement.
- **Recharge Service through Automatic Teller Machine:** Enables SAWA customers to use the bank's automatic teller machines to recharge their SAWA service. This service is now applied by the National Commercial Bank.
- **Lana Service:** A prepaid mobile SIM service assigned to the youth, with free messages and games. A discount is applied for calls between these SIMs.
- **New Recharge Cards (SR 10 and SR 20):** SAWA recharge cards with low values of SR 10 and SR 20.

ALHATIF

- **Hot line Service:** Automatic dial-up to a customer program number within selected by the customer, 5 seconds of picking up the hand set.
- **DSL Service 512 kb/s:** Connects ALHATIF customers to the Internet at the speed of 512 Kb/s.
- **Favorite Country Service:** Offers the customers a 25% discount on call charges to 5 numbers in one country selected by the customer.
- **Speaking Clock Service:** Developed to allow the user to select the language informing the caller of the date, time and prayer times for the city from which he is calling. The service number was changed to the numbers '1222' so that the customer can more easily remember it.

Saudi Data

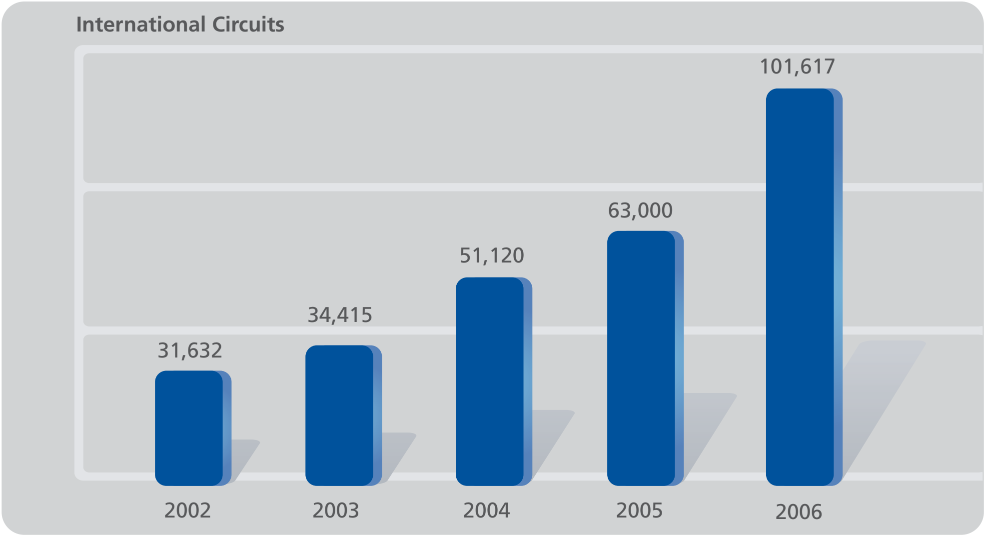
- **Urgent Installation Request Service:** Used to provide expedited service within 15 working days, or 5 working days for critical requests.
- **Filtered Capacity Service for Internet Service Providers:** Used to provide direct link service to the Internet for Internet Service Providers.
- **Access Service (WiMax):** Used to access virtual networks to serve customers who do not have broadband services via landline networks.



Wholesale Services

The number of International Exchanges has increased from 3 to 4, while the capacity of routes was upgraded to 622 Mb/s and 2.5 Gb/s. Moreover, STC participated in the preparatory activities meetings to place a number of regional submarine cables. The National Roaming Service Agreement was renewed as well as number mobility service with the second Mobile operator. The Reference Interconnection Offer (RIO) was updated.

increase in international circuits from 2004 to 2006



Information Technology

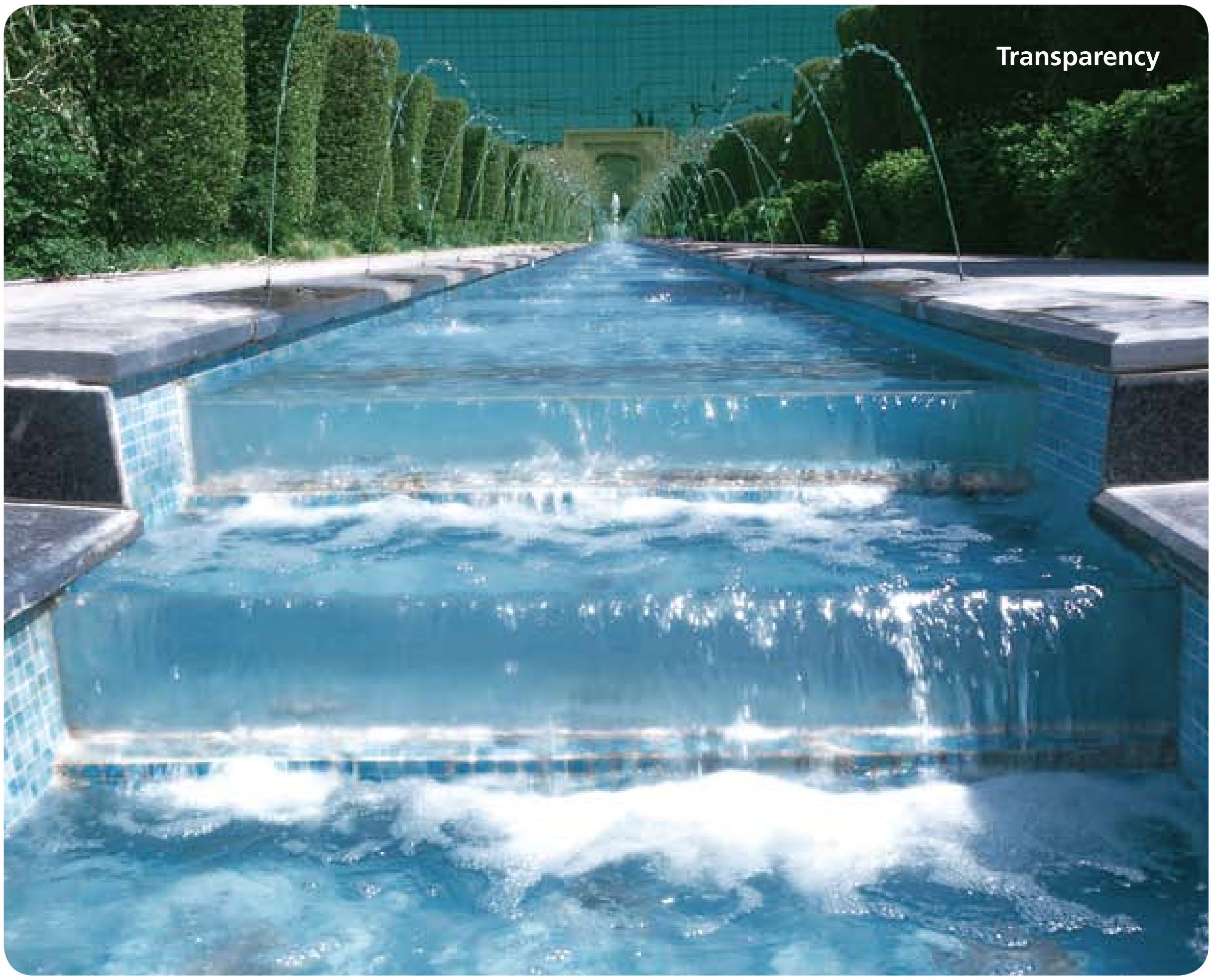
- The billing system for new international roaming services, which handles all current and future international requirements, has been applied.
- Customer Relation Management System for the Saudi Data Service Unit using the best international professional practices.
- The regulations concerning billing and ALJAWAL Customer Care have been implemented after completing all agreement with systems and services suppliers.
- IT systems readiness for handling national payment system was completed (Sadad), including the implementation of a link with two banks by the end of 2006 and approval of plans to link the remaining banks in 2007.
- Electronic business systems (e-Biz) were developed and many new services were added to automate dealing with customers via the company website (Khadmati) and dealing with company employees through company's internal website (the link).
- A number of financial, administrative and HR systems were completed in view of the Company's program to automate all internal systems.

4 Prices

ALJAWAL

Under strong competition in the mobile and voice services market, the Company managed the price structure in a balanced way to maintain its position and reputation in the market as well as to maintain the international ARPU level. Thus the Company made the following discounts:

- Changed **"SAWA"** SIM rate from SR 150 to SR 100 without change to the minute rate.
- Up to **14%** discount for all local calls within and outside the network.
- 5 Halas deducted from "ALJAWAL 45" rate **30** Halalas per minute.
- 5 Halas deducted from "ALJAWAL 35" rate **40** Halalas per minute.
- Reduced the **"SAWA"** calling tariff inside the network up to **23.5%**.
- The international SMS charges dropped from 60 Halalas to 45 Halalas.
- Two new recharging cards (SR10 / SR 20) were launched for SAWA customers.

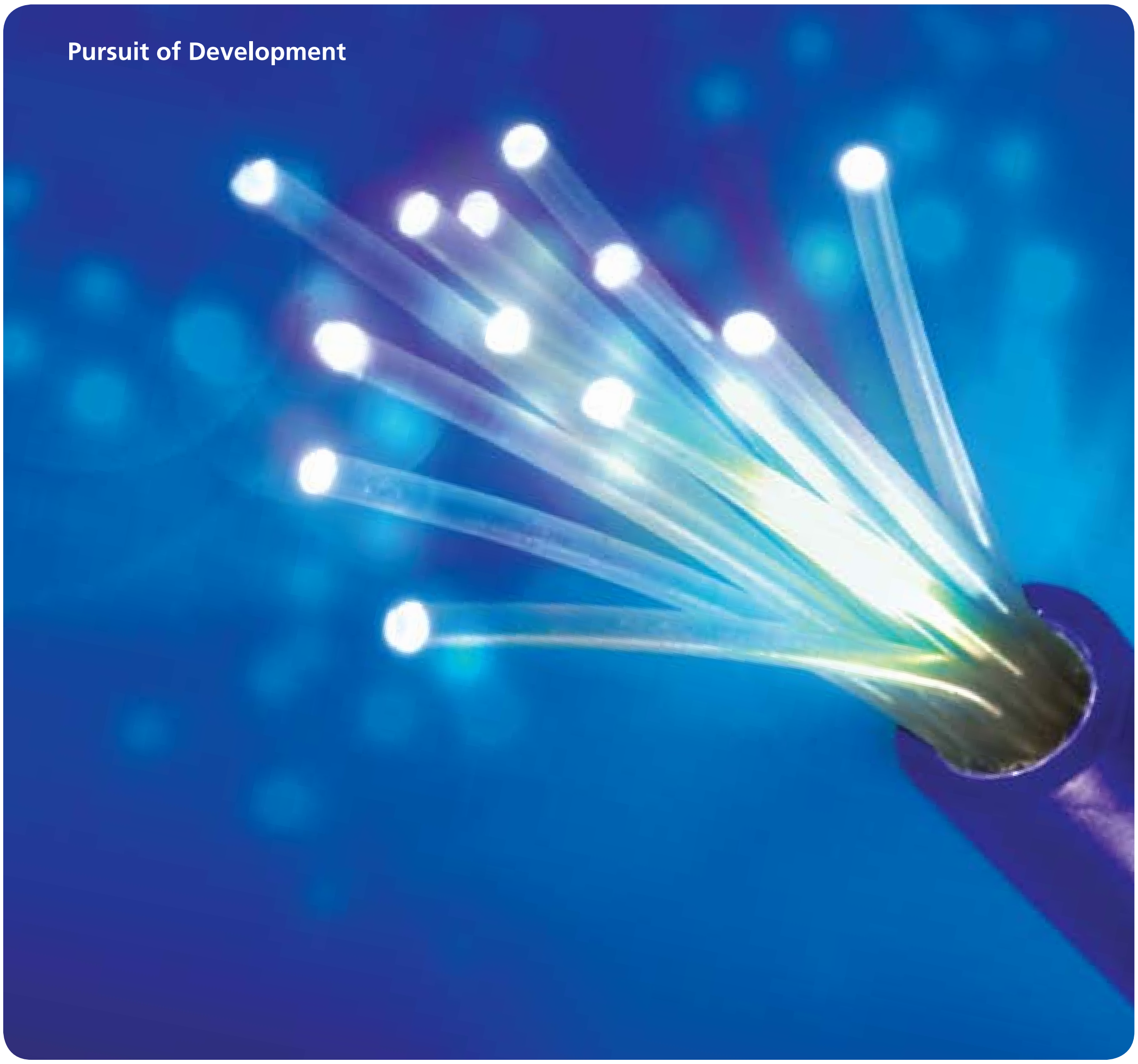


ALHATIF

- ALHATIF **"30"** national call charges reduced by **50%** for all distances at all times.
- ALHATIF **"45"** local call charges reduced to **50%**.
- International calls from public call cabins and prepaid call-cards reduced by **25%**.
- Reduction in all international calls charges by **17%** to all countries.

Saudi Data

- Installation and connection charges for Sky Internet were reduced by more than **50%**.
- Installation and connection charges for high speed Internet service was reduced by **15%**.
- Connection charges for DSL reduced by **50%**.
- Subscription charges for DSL reduced by **17%**.



5 Strategic Investments:

The STC Strategic plan aims to realize 10% of Company revenues from external profitable investments whether inside or outside the Kingdom by the year 2010. To achieve this objective, the STC investment strategy was developed and approved, containing major dimensions such as targeted sectors, geographical scope for investment, the percentages of targeted ownership, size of investment, investment mechanisms, financing and exit strategy.

Based on this strategy and recognizing in local available opportunities to realize lucrative returns for shareholder, there was investment by establishing Saudi Tijari Company in association with Technology Investments and the National Information Systems Company which is a limited liability company establishing, operating and managing platforms and e-markets to perform sale and purchase process electronically as well as making auctions and doing all commercial transactions between corporations and companies in public and private sectors.

Also a memorandum of co-operation in the field of technology incubators (container, database) was signed between STC and King Abdul Aziz City for Science and Technology (KACST) to invest in establishing Telecommunications and IT sector incubators to encourage initiatives in this field.

The Company continues to study several external investment opportunities according to the above mentioned plan.

6 Human Resources:

The Company pays major attention to its human resources and to the development of their skills according to a clear vision through which many programs and projects were implemented during the year 2006. The most important of which are:

HR Policies and Regulations

Human resources policies manual was approved after inclusion of new regulations and mechanisms.

STC Staff Model

The Staff Model of the Company was determined according to the study of intentional manpower indicators.

Career Path and Leadership Development Programs:

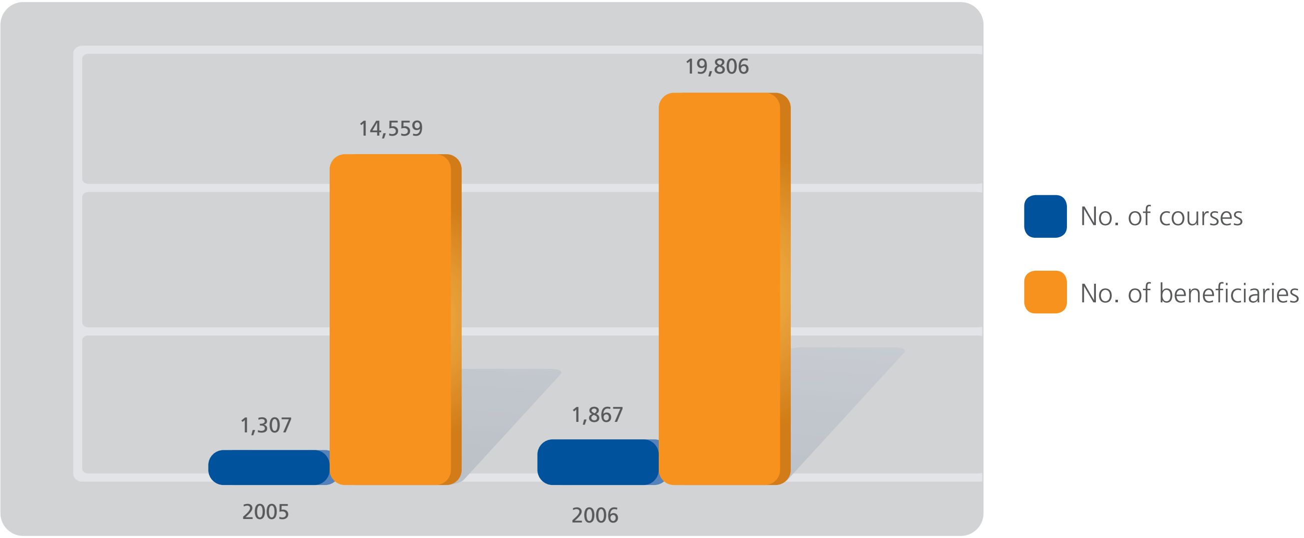
The Company adopted many developmental and strategic programs for management leaders, including a succession planning project, which was implemented at VP and GM levels. A measurement of competency and personal skills was conducted by Competency Measurement Agencies.

Saudization :

Saudization percentage reached 90% in 2006, exceeding the year 2005 by 2%.

Training

1867 training courses and symposiums were held during 2006 for the various managerial and technical levels in the Company, to develop employee skills and capabilities. 19,806 employees (87% of company employees) benefited from this program.

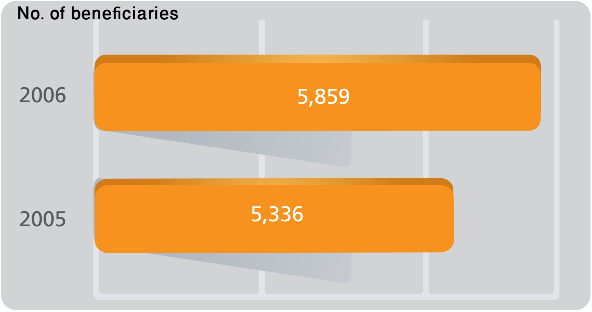


Manpower Enhancement Program

The Company continued with the execution of its program aiming at enhancement of manpower performance, enhancement of the internal business environment and reduction of manpower and cost. This was done through the presentation of the Early Retirement Program for the segment target. 523 employees accepted this program during 2006, so the total number for those accepted in the program till the end of the year 2006 reached 5859 employees.

10%

Increase in the total number of those who benefited (beneficiaries) from manpower enhancement program through 2005 - 2006



Housing Loans

The implementation of the housing loans program continued and 449 employees benefited from it during the year 2006, so the number of beneficiaries reached 1162 employees by the end of 2006. The total approved amount for the program was SR 800 million.

Summer recruitment and cooperative training program:

In addition to implementation of the recruitment plan, in view of the social service program, the Company recruited (2264) students during the summer holiday, and trained more than (2000) students through the University & College Students Training Program, and provided training to (1697) of its employees family members .

Social Welfare Fund

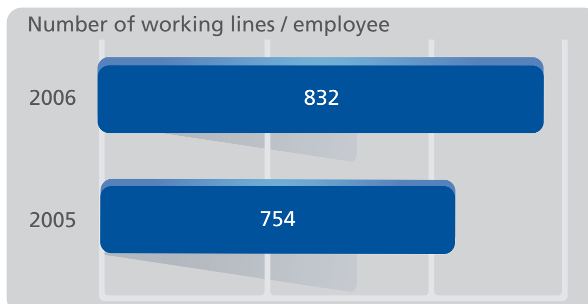
The Company launched the Social Welfare Fund to strengthen ties and co-operation between employees who subscribe to this program, through non-refundable contributions distributed to assist needy employees and offering of interest -free loans. The number of subscribers reached 2542 employees by the end of the year.

Productivity

10%

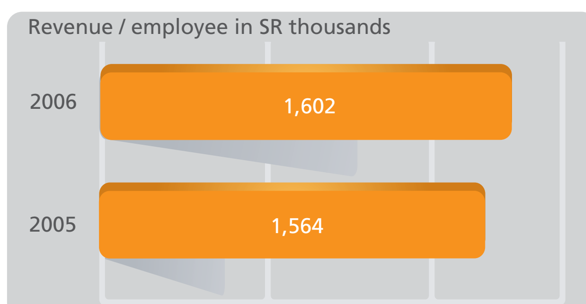
Increase in the STC employee productivity based on the total number of working lines (ALHATIF – ALJAWAL) 2005 to 2006

There is a continuous increase in STC employees' productivity rates according to the following:



2,5%

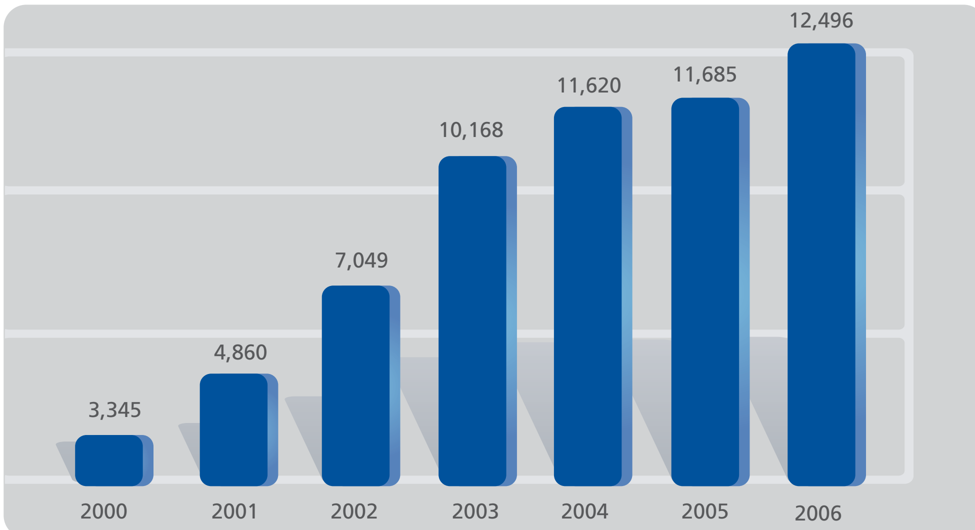
STC employee productivity based on revenues per employee (thousands of Riyals) 2005 to 2006



7 Economic and Social Roles of the Company:

The Company directly contributed to the GDP more than SR 61,223 billion by the end of the Year 2006, representing the charges paid to the Government and its share in annual dividends:

STC Contribution to GDP (SR in millions)



7,5%

Increase in GDP contribution 2004 to 2006

In line with STC preparation for implementation of e-government, the Company has provided network connections and internet services that comprised the e-government infrastructure for KSA. Also, as part STC contribution in the field of social services, the Company launched "Al Wafa'a" program through which many initiatives were activated, such as:

- **Al Wafa'a Health program** through which the Company donated (100) million Riyals for building and preparing 28 clinics in different regions of the Kingdom.

- **Al Wafa'a Sports program** for Saudi Basketball association activities sponsoring all super tournament clubs. STC continued sponsoring numerous social, tourism, economic and cultural activities Kingdom-wide in addition to its professional active participation abroad. Similarly, the Company participated in offering many training programs to the employees' families to give them a chance to acquire some skills in using computers and applications, first aid and international computer driving license (ICDL).

8 STC Future Directions, Technological Developments and Achievements:

STC has developed a new strategy in order to face the future challenges, such as increasing competition due to imminent entrance of a third mobile operator and a second landline operator, the changing international market environment such as companies consolidation and the technological changes in communication networks and services. STC has finalized its new FORWARD strategy for the next four years, to be able to develop its income, sustain its leading position in the local market, working with greater efficiency through cost optimization and building an organization that focuses on the customer (customer centricity).

F	>>	Fulfill Mobile Potential	استمرار دورنا الريادي في سوق الجوّال	<<	ا
O	>>	Offer Wholesale Services	لعب الدور الرئيسي في تقديم الخدمات للنواقل والمشغلين	<<	ل
R	>>	Re-invent Home Communication	طرق خدمات متطورة للتواصل المرئي المعلوماتي من المنزل	<<	ط
W	>>	Win Enterprise Customers	للتميز في خدمة متطلبات قطاع الأعمال	<<	ل
A	>>	Achieve External Growth	يقين بتحقيق التوسع الخارجي	<<	ي
R	>>	Re-organize Internal Structure	عزم على تطوير الهيكلة الداخلية	<<	ع
D	>>	Derive Operational Efficiencies	تحقيق الكفاءة التشغيلية	<<	ة

Technological Achievements

STC realized many technical achievements in 2006 as follows:

Roll-out of ALJAWAL 3.5G network in 21 Cities

Migration from ATM to an IP/MPLS Network

Building of a Modern International Information Services Center:

In a step towards providing data services to the enterprise sector in KSA, a strategic agreement was concluded with (AT&T) and (Navlink) for establishing an international center for MPLS in the Kingdom which, is planned to launch in the first half of 2007, connecting STC national MPLS network to the (AT&T) network – considered one of the strongest data transmission networks in the world. This will enable STC customers in the business sector to reach their branches in more than 150 countries all over the world, and also enables international companies to communicate with their branches in the Kingdom.

Relocation of Internet Gateway from KACST to STC

According to the Council of Ministers decree No. 229 issued on 13/8/1425 H, stipulating the restructuring of the internet services in KSA, STC will replace KACST and assume internet operation responsibilities. Accordingly, all ISPs lines were transferred to the new international gateway in Riyadh which was especially established for this purpose to work as a branch of the international gateway in Jeddah. KACST employees were transferred to STC thus ensuring high quality & reliability of internet services.

Increasing Operational efficiency

STC is considered one of the first national companies to apply the True Shared Services concept, aiming to provide high quality services, based on the sharing costs between sectors that provide services and the beneficiaries, to realize cost reduction, service improvement, and speedy performance.

(NGN) Next Generation Networks

This technology shall replace the traditional exchange network and is designed to transfer voice over an IP data network, by which all services (e.g. voice, video and data) are transferred in packets, increasing network efficiency and boosting its performance.

Digital Subscriber Line xDSL

To meet the increasing demand for broadband service, the Company executed the largest expansion in its network during 2006 to provide broadband service through the existing copper wires.

IP/MPLS

IP/MPLS is the latest communications networks and information services technology. The total capacity of this network reached (880 Gb) and will be the main network used for NGN technology, to provide all communication services: voice, video etc.

Dense Wavelength Division Multiplexing (DWDM)

This technology will make it easy to put high capacities on the existing optical fiber network connecting cities throughout the Kingdom, by using different optical waves.

Code Division Multiplex Access (CDMA 450)

This technology is used to serve rural areas with voice services, by using the 480 megahertz frequency.

9 Board of Directors Recommendations and Dividends Distribution:

Proposed dividends distribution for the year 2006

Board of Directors suggested a total profit to be distributed at the end of the fiscal year 2006 at a rate of 5.75 Riyals per share.

Board of Director’s compensations

Board of Directors allowances and compensations for attending board and committee meetings for the year 2006 amounted to (SR 2,616,000). The Board recommended to pay (SR 200,000) as an annual reward for the year 2006 for all members according to Article (46) of the "Article of Association" of the Company.

Recommendations

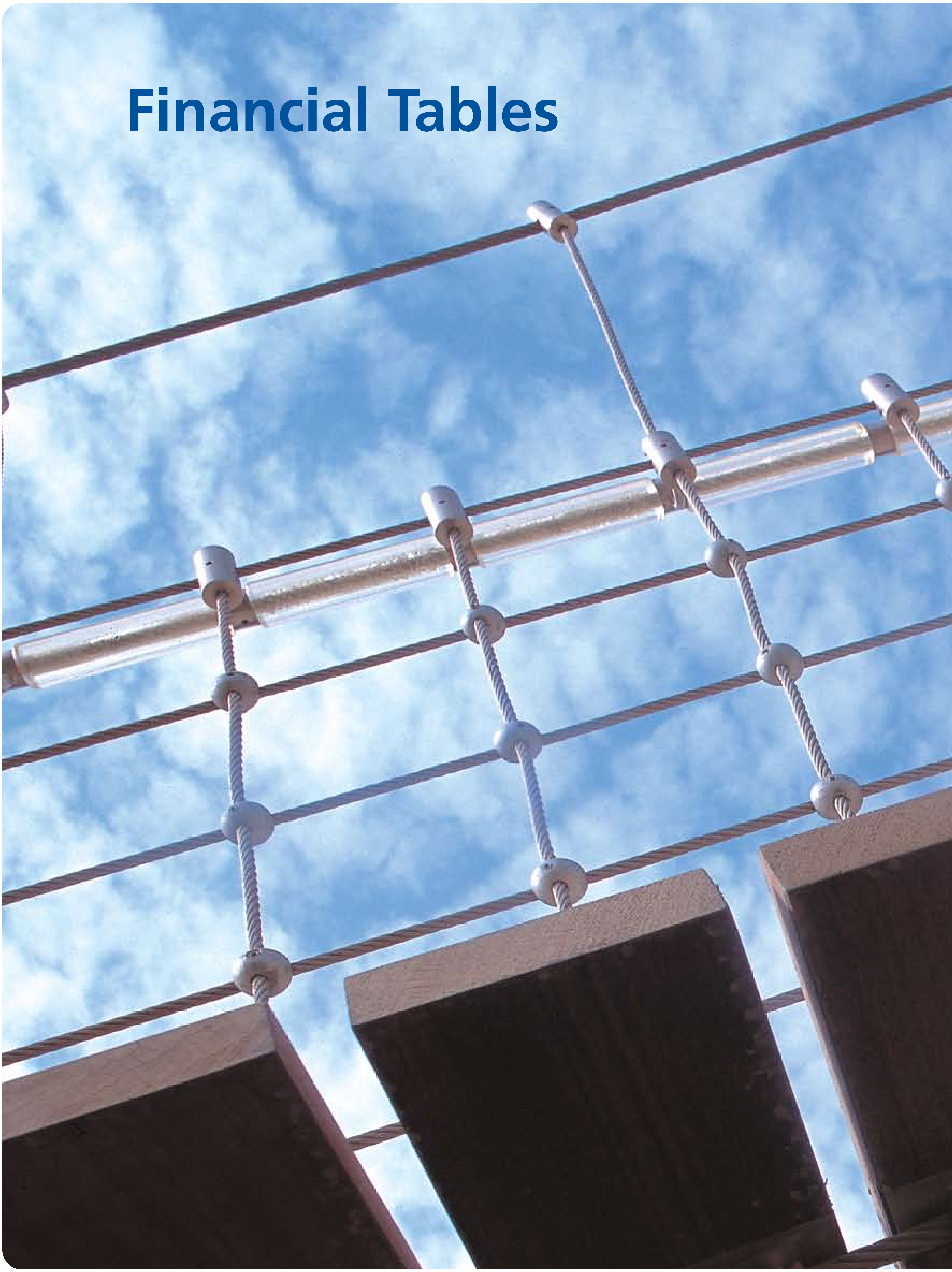
The Board of Directors recommendations to your esteemed shareholders are as follows:

- Approval of the Board of Directors' statement for the fiscal year ended in 31/12/2006.
- Approval of the financial statements of the Company and the auditors accounting reports for the fiscal year ended on 31/12/2006.
- Approval of the Board of Directors proposal regarding the distribution of the fourth quarter of the fiscal year 2006 profits at a rate of (SR 1.5) per share, in addition to what has been distributed for the third quarter of the year 2006 as (SR4.25) per a share, so the total amount of the profits distributed for the fiscal year 2006 will be (5.75) per a share.
- Approval of hiring accounting auditors from the auditors nominated by the audit committee, to review the financial statements for the year 2007, the quarterly financial data and define their fees.

Conclusion

The Board of Directors praises Allah first & extends thanks to our government, for its support and encouragement extended to the Company, expressing its appreciation to share holders and customers for their trust, to all employees of the Company for their devotion and dedication in performing their work and to all STC partners. The Board also emphasizes the Company's continuous development of its services to satisfy and fulfill the needs of its customers, realize its shareholders aspirations, serve the social goals and sustain the leading position of the national company in the telecommunication sector in the Kingdom.

Financial Tables



AL JURAID & COMPANY
MEMBER FIRM OF
PRICEWATERHOUSECOOPERS

Deloitte & Touche
Bakr Abulkhair & Co.
Deloitte.

INDEPENDENT AUDITORS' REPORT

To the shareholders
Saudi Telecom Company
(A Saudi Joint Stock 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, 2006 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 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, segmental information was not disclosed in the notes to financial statements as required by generally accepted accounting standards in the Kingdom of Saudi Arabia.

In our opinion, except for the matter referred to 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, 2006 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.

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W. Shu

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Registration No. 329

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Saudi Arabia

Bakr A. Abulkhair
Registration No. 101

Riyadh, Safar 7, 1428
February 25, 2007

Balance sheet as of December 31, 2006

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

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

Statement of income for the year ended December 31, 2006 (Saudi Riyals in thousands)

	Notes	2006	2005
Operating Revenues			
Wireless		24,023,115	23,514,231
Wire line		9,762,774	9,025,712
Total operating revenues	20	33,785,889	32,539,943
Operating Expenses			
Government charges	21	(4,446,169)	(5,175,322)
Access charges		(4,325,210)	(2,519,941)
Employee costs	22	(4,206,494)	(3,883,083)
Depreciation and amortization	8,9	(3,835,792)	(3,836,211)
Administrative and marketing expenses	23	(2,886,446)	(2,140,781)
Repairs and maintenance		(1,437,633)	(1,622,552)
Total operating expenses		(21,137,744)	(19,177,890)
Operating Income		12,648,145	13,362,053
Other Income and Expenses			
Cost of manpower improvement program	24	(500,000)	(519,903)
Commissions	3, 4, 11	416,613	207,274
Earnings from investments accounted for under the equity method	10	101,631	106,680
Other, net	25	475,089	(416,994)
Other income and expenses, net		493,333	(622,943)
Net Income before Zakat		13,141,478	12,739,110
Provision for Zakat	26	(342,576)	(292,249)
Net Income		**12,798,902**	**12,446,861**
Basic earnings per share in Saudi Riyals		**6.40**	**6.22**

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

Statement of cash flows for the year ended December 31, 2006 (Saudi Riyals in thousands)

	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	12,798,902	12,446,861
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,835,792	3,836,211
Doubtful debts expense	435,602	272,393
Earnings from investments accounted for under the equity method	(101,631)	(106,680)
Provision for capital work in progress	(24,057)	389,251
(Gains)/ losses on sale/ disposal of property, plant and equipment	(12,600)	79,715
Losses/ (Gains) on sale of other investments	2,450	(50,304)
Capitalized commission write-off	-	304,184
Changes in:		
Accounts receivable	(750,607)	(762,465)
Inventories	3,588	64,362
Prepayments and other current assets	(292,221)	(276,850)
Other non-current assets	(243,828)	(433,338)
Accounts payable	(646,038)	(122,626)
Other payables	219,719	(743,439)
Accrued expenses	572,543	1,596,618
Deferred revenue	(132,848)	(179,966)
Employees' end of service benefits	207,862	(30,870)
Net cash provided by operating activities	15,872,628	16,283,057
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(3,392,713)	(4,389,144)
Short-term investments	(1,904,000)	(1,960,000)
Investment in Sabic's Sukuk	(150,000)	-
Proceeds from sale of other investments	97,550	105,953
Dividends received from investments accounted for under the equity method	18,209	16,694
Investment in Tejari Saudi Arabia	(14,700)	-
Proceeds from sale of property, plant and equipment	19,769	28,835
Intangible assets	-	(753,750)
Net cash used in investing activities	(5,325,885)	(6,951,412)
CASH FLOWS FROM FINANCING ACTIVITIES		
Dividends paid	(11,642,243)	(10,340,529)
Net cash used in financing activities	(11,642,243)	(10,340,529)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(1,095,500)	(1,008,884)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	4,004,821	5,013,705
CASH AND CASH EQUIVALENTS AT END OF YEAR	**2,909,321**	**4,004,821**

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

Statement of changes in shareholder's Equity for the year ended December 31, 2006

(Saudi Riyals in thousands)

	Notes	Common Shares	Statutory Reserve	Retained Earnings	Unrealized Loss On Other Investments	Total Shareholders' Equity
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**
Net income		-	-	12,798,902	-	12,798,902
Dividends	14	-	-	(11,500,000)	-	(11,500,000)
Transfer to capital	18	5,000,000	-	(5,000,000)	-	-
Transfer to statutory reserve	19	-	1,279,890	(1,279,890)	-	-
Balance at December 31, 2006		**20,000,000**	**5,818,458**	**8,339,223**	**(3,342)**	**34,154,339**

The accompanying notes from 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. A new GSM operator started its operations in May 2005. During 2003, the Communications and Information Technology Commission ("CITC") issued licenses for Very Small Aperture Terminals (V-SAT), and also issued licenses, during 2004, for the provision of data services.

2 SIGNIFICANT ACCOUNTING POLICIES

The accompanying 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 fiscal 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 fractions of traffic minutes processed, applying rates approved by the CITC.
- Charges billed in advance are deferred and recognized over the period in which the services are rendered. Unbilled revenue is recognized in the period to which it relates.
- Revenue is recognized upon collection when collectability is highly uncertain.
- Non-refundable up-front activation fees received from customers up to the end of the first quarter 2006 were deferred and recognized over the estimated service lives for the customers. Non-refundable up-front activation fees are recognized upon receipt, starting from the second quarter 2006.
- Wireless revenues are composed mainly of mobile, international and national roaming services, while wireline revenues are composed mainly of fixed lines, international settlements, leased circuits, data and internet services.

Notes to the financial statements for the year ended December 31, 2006

c) Cash and cash equivalents

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

d) Accounts receivable

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

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, landline, 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 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 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 recorded based on a valuation performed by the Company with the assistance of independent international and local valuation experts. The principal bases used for valuation are as follows:

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

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

(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 case they are capitalized.

(6) The Company reviews periodically its property, plant and equipment to determine whether any of the assets are permanently impaired, whenever events or changes in circumstances indicate that. The amount of impairment is included in the statement of income in the period when such determination is made, and property, plant and equipment is reported net.

(7) Gains and losses resulting from the disposal / sale of property, plant and equipment are determined by comparing the proceeds with the book values of disposed-off / sold assets, and the gains or losses are included in the statement of income.

h) Intangible assets

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

i) Software costs

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

j) Investments accounted for under the equity method

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

k) 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 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. Losses resulting from permanent decline in fair values below costs are recorded in the statement of income in the period in which the decline occurs.

- Investments held to maturity are recorded at cost and adjusted for amortization of premiums and accretion of discounts, if any. Losses resulting from permanent decline in fair values below costs are recorded in the statement of income in the period in which the decline occurs.
- 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.

l) Zakat

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

m) Employees' end of service benefits

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

n) 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 of foreign currency denominated monetary balances to Saudi Riyals, are recorded in the statement of income.

o) Government charges

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

p) 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.

q) 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.

r) Earnings per share

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

3 CASH AND CASH EQUIVALENTS

A part of surplus cash is invested in Murabaha deals with maturity periods of 90 days or less with several local banks. The average rate of commission on these deals during the year was 4.4% (2005: 4.5%). Total commission earned on these deals during the year was SR 154.3 million (2005: SR 88.7 million).

Investments during 2005 were through bank time deposit accounts with maturity periods of 90 days or less, which had been liquidated before the end of the second quarter of 2005. Total commission earned on time deposits before conversion to Murabaha amounted to SR 28.6, with average commission rate of 3.1%.

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

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

(Saudi Riyals in thousands)	2006	2005
Collection accounts	2,444,490	2,492,295
Short-term Murabaha deals	302,505	1,256,500
Disbursement accounts	162,326	256,026
	2,909,321	4,004,821

4 SHORT-TERM INVESTMENTS

A portion of the surplus cash is invested in Murabaha deals with maturity periods of more than 90 days. The average rate of commission on these deals during the year was 5.3% (2005: 5.6%). Total commission earned on these deals during the year was SR 254.4 million (2005: SR 46.1 million).

Investments during 2005 were through bank time deposit accounts with maturity periods of more than 90 days, which had been liquidated before the end of the second quarter of 2005. Total commission earned on time deposits before conversion to Murabaha amounted to SR 28.3 million, with average commission rate of 3.5%.

5 ACCOUNTS RECEIVABLE, NET

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

(Saudi Riyals in thousands)	2006	2005
Billed receivables	3,143,447	2,378,959
Unbilled receivables	1,370,632	1,788,585
	4,514,079	4,167,544
Allowance for doubtful debts	(575,440)	(543,910)
	3,938,639	3,623,634

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

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

(b) Since inception, the Company recognizes revenues from services rendered to particular customers upon collection where collectability is highly uncertain. The Company is currently pursuing the collection of these revenues. Uncollected revenues from such customers for the year 2006 amounted to SR 104 million (2005: SR 156 million), with an annual average of SR 220 million for the seven years preceding 2006.

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

(Saudi Riyals in thousands)	2006	2005
International accounts receivable, net	347,006	484,033
International accounts payable, net	862,191	755,530

(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:

(Saudi Riyals in thousands)	2006	2005
Balance at January 1	163,744	230,473
Additions	123,633	323,512
Usage	(128,414)	(390,241)
	158,963	163,744
Inventory allowance	(9,263)	(10,456)
Balance at December 31	149,700	153,288

7 PREPAYMENTS AND OTHER CURRENT ASSETS

Prepayments and other current assets consisted of the following:

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

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

8 PROPERTY, PLANT AND EQUIPMENT, NET

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

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

(b) In accordance with the Royal Decree referred to in Note (1), the ownership of assets have been transferred to the Company as of May 2, 1998. However, the transfer of legal ownership of certain land parcels is still in progress. Land parcels for which legal ownership has been transferred into the Company' name amounted to SR 1,615 million as of December 31, 2006. The transfer of the ownership of the remaining land parcels with a value of SR 684 million is still in progress.

(c) During the year 2005, the Company reviewed its property, plant and equipment and capital work in progress, and as a result capitalized commission amounting to SR 304 million was written-off, and a provision of SR 389 million was created against capital work in progress. The provision has been cleared during the year 2006.

9 INTANGIBLE ASSETS, NET

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

Intangible assets consist of the following as of December 31:

(Saudi Riyals in thousands)	2006	2005
License for the Third Generation (3G) mobile services:		
Cost	753,750	753,750
Amortization during the year	(21,984)	–
Net book value at December 31	731,766	753,750

10 INVESTMENTS ACCOUNTED FOR UNDER THE EQUITY METHOD

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

(Saudi Riyals in thousands)	2006		2005	
	Ownership		Ownership	
Arab Satellite Communications Organization ("Arabsat")	36.66%	925,647	36.66%	846,633
Arab Submarine Cables Company Ltd.	44.29%	49,779	42.86%	45,371
Tejari Saudi Arabia	50.00%	14,700		–
		990,126		892,004

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.

Tejari Saudi Arabia

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

11 OTHER INVESTMENTS

(a) Other investments consist of the following:

(Saudi Riyals in thousands)	2006	2005
Held to maturity:		
Investment in Sabic's Sukuk	150,000	–
Notes	–	100,000
	150,000	100,000
Available for sale – at market value:		
Investment in New ICO	33	33
Total other investments	150,033	100,033

(b) The Sukuk were acquired from the Saudi Basic Industries Corporation "Sabic" in July 2006 for SR 150 million, with maturity of 5 years up to July 2011, and a commission rate equal to the Saudi Inter-Bank Offered Rate ("SIBOR") plus 0.40%. Commission earned from these Sukuk during the year 2006 amounted to SR 3.7 million.

(c) Notes issued by a local bank were acquired at the end of 2004 for SR 100 million, with maturity period of seven years up to December 2011, callable after five years, bearing floating commission rates. The notes were sold during the year 2006 and a loss on sale amounting SR 2.45 million was realized. Commission earned from these notes during the year 2006 amounted to SR 1.9 million. (2005: SR 4.4 million).

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

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

12 OTHER NON-CURRENT ASSETS

Other non-current assets consist of the following:

(Saudi Riyals in thousands)	2006	2005
Employee housing loans	703,687	441,362
Deferred costs	55,496	73,993
	759,183	515,355

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

13 ACCOUNTS PAYABLE

(a) Accounts payable consist of the following:

(Saudi Riyals in thousands)	2006	2005
Government charges	672,852	1,113,256
International settlements	862,191	755,530
Trade	386,811	548,260
Capital expenditures	38,083	188,929
	1,959,937	2,605,975

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

14 DIVIDENDS PAYABLE

Movement in dividends during the year was as follows:

(Saudi Riyals in thousands)	2006	2005
Balance at January 1	207,249	47,778
Dividends declared for the fourth quarter 2005	3,000,000	–
Dividends declared for the first quarter 2006	2,500,000	–
Dividends declared for the second quarter 2006	3,000,000	–
Dividends declared for the third quarter 2006	3,000,000	–
Dividends declared for the second half of 2004	–	4,200,000
Dividends declared for the first half of 2005	–	4,200,000
Dividends declared for the third quarter 2005	–	2,100,000
	11,707,249	10,547,778
Payments made during the year	(11,642,243)	(10,340,529)
Balance at December 31	65,006	207,249

15 OTHER PAYABLES

Other payables consist of the following:

(Saudi Riyals in thousands)	2006	2005
Suppliers' retentions	867,279	866,720
Provision for Zakat (Note 26)	296,799	284,325
Settlement of seconded employees' entitlements	282,052	338,635
Withholding tax provision	260,410	121,016
Manpower improvement program	252,005	47,428
Frequency evacuation project (Note 7)	250,000	250,000
Refundable customers' guarantee deposits	90,826	83,366
Other	55,844	144,006
	2,355,215	2,135,496

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

The Council of Ministers' Resolution No. 198 dated 18 Rajab 1424 H (September 15, 2003) approved the system of exchanging benefits between the Civil and Military Pension System and the Social Insurance System. The estimated amount has been reconciled based on the actual number of employees who 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:

(Saudi Riyals in thousands)	2006	2005
Capital expenditures	1,583,649	1,963,930
Trade	1,029,007	202,418
Employee accruals	938,950	834,229
Land provision	197,671	176,157
	3,749,277	3,176,734

17 EMPLOYEES' END OF SERVICE BENEFITS

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

(Saudi Riyals in thousands)	2006	2005
Balance at January 1	1,612,540	1,643,410
Charges (Note 22)	325,760	298,692
Settlements	(117,898)	(329,562)
Balance at December 31	1,820,402	1,612,540

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

18 SHARE CAPITAL

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

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

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

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

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

19 STATUTORY RESERVE

10% of annual net income is appropriated as statutory reserve until such reserve equals 50% of issued share capital. This reserve is not available for distribution to the Company's shareholders. During the year 2006 the Company appropriated an amount of SR 1,280 million (2005: SR 1,245 million). The statutory reserve on December 31, 2006 amounted to SR 5,818 million, which represents 29% of share capital (December 31, 2005: SR 4,539 million, which represents 23% of share capital).

20 OPERATING REVENUES

Operating revenues consist of the following:

(Saudi Riyals in thousands)	2006	2005
Usage charges	26,790,008	25,835,087
Subscription fees	5,150,241	4,725,254
Activation fees	586,437	582,700
Other	1,259,203	1,396,902
	33,785,889	32,539,943

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

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

21 GOVERNMENT CHARGES

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

(Saudi Riyals in thousands)	2006	2005
Commercial service provisioning	3,993,517	4,540,696
License fees	284,903	302,713
Frequency spectrum	167,749	331,913
	4,446,169	5,175,322

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

(a) Commercial Service Provisioning

- The fees for commercial provisioning of all services, except Data, are 15% of net revenue (as defined above). The fees for Data services are 8% of net revenue, applied effective the beginning of 2005, which resulted in a reduction in the fees recalculated by the Company during 2006.
- The Council of Ministers issued a Resolution in its meeting dated 10 Moharam 1428 H (January 29, 2007) amending the fees for commercial provisioning of landline services to 10%, instead of 15%, effective from 22 Dhul Hijja 1428 H (January 1, 2008).

(b) License Fees

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

(c) Frequency Spectrum

The fees for usage of the frequency spectrum are calculated in accordance with the pricing list issued by the CITC, the application date of which corresponds to 25 Dhul Quada 1425 H (January 6, 2005). The new method of calculating the fees depends on various factors, the most important of which being the locations and widths of required frequencies, distances covered and technologies applied.

The Company reviewed the frequency tables in order to specify its actual requirements and, accordingly, determine the ultimate cost, which resulted in a reduction in the fees recalculated by the Company during 2006. An agreement has been reached on the reconciliation of most amounts due, however, the final frequencies table is being worked upon with the CITC.

(d) An amount of SR 97.9 million has been recorded as an accrued receivable related to government charges paid by the Company on behalf of the new mobile operator (Mobily) in 2006.

22 EMPLOYEE COSTS

Employee costs consist of the following:

(Saudi Riyals in thousands)	2006	2005
Salaries and allowances	2,964,289	2,819,381
Incentives and rewards	397,316	279,201
End of service benefits	325,760	298,692
Social insurance	256,469	234,608
Medical insurance	153,415	150,376
Vacations	50,855	38,158
Other	58,390	62,667
	4,206,494	3,883,083

23 ADMINISTRATIVE AND MARKETING EXPENSES

Administrative and marketing expenses consist of the following:

(Saudi Riyals in thousands)	2006	2005
Sales commissions and advertising expenses	1,288,090	835,603
Doubtful debts expense (Note 5)	435,602	272,393
Printing of telephone cards and stationery	245,637	199,302
Consultancy	199,898	111,388
Rent of equipment, property and motor vehicles	137,890	116,787
Utilities	151,607	167,901
Training	77,264	87,296
Telecommunications, courier and delivery	104,414	144,579
Safety expenses	79,827	78,334
Other	166,217	127,198
	2,886,446	2,140,781

During the year 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 2006 represents the cost of implementing the sixth phase of the Company's manpower improvement program which was initiated during 2001. The following schedule shows the cost of fifth and sixth phases:

(Saudi Riyals in thousands)	Implementation Date	Cost
The Fifth Phase	2005	519,903
The Sixth Phase	2006	500,000
Total		1,019,903

25 OTHER INCOME AND EXPENSES, NET

Other income and expenses consist of the following:

(Saudi Riyals in thousands)	2006	2005
Miscellaneous revenue	551,019	311,239
(Losses) / Gains on sale of other investments (Note 11)	(2,450)	50,304
Provision for capital work in progress	-	(389,251)
Capitalized commission write-off	-	(304,184)
Gains / (losses) on sale / disposal of property, plant and equipment	12,600	(79,715)
Miscellaneous expenses	(86,080)	(5,387)
	475,089	(416,994)

"Miscellaneous revenue" in the year 2006 includes an amount of SR 62.3 million which represents an accrued receivable related to government charges paid by the Company on behalf of the new mobile operator (Mobily) in 2005.

"Miscellaneous expenses" in the year 2006 includes an amount of SR 25 million, representing amount expensed during the period out of SR 100 million donated by the Company to the Ministry of Health under "Alwafaa" Health Program.

26 ZAKAT

(a) Zakat base

(Saudi Riyals in thousands)	2006	2005
Share capital – beginning of the year	15,000,000	15,000,000
Additions:		
Retained earnings – beginning of the year	13,320,211	12,618,036
Statutory reserve – beginning of the year	4,538,568	3,293,882
Provisions – beginning of the year	3,016,639	2,967,270
Adjusted net income	13,703,066	11,689,956
Total additions	34,578,484	30,569,144
Deductions:		
Net property, plant & equipment, capital work in progress and intangible assets (limited to shareholders' equity before Zakat)	(30,860,149)	(31,286,340)
Dividends paid	(11,642,243)	(10,340,529)
Investments	(1,140,159)	(992,037)
Non-current deferred costs	(55,496)	(73,993)
Total deductions	(43,698,047)	(42,692,899)
Zakat base	5,880,437	2,876,245

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

(Saudi Riyals in thousands)	2006	2005
Balance at January 1	284,325	233,640
Charge for the year	342,576	292,249
Amounts paid during the year	(330,102)	(241,564)
Balance at December 31	296,799	284,325

Final Zakat assessments have been obtained for the years since inception through 2003. The final Zakat assessments for 2004 and 2005 have not yet been finalized. The Company has received a Zakat Certificate which is valid up to 13 Rabie II 1428 H (April 30, 2007).

27 BORROWINGS

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

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 2006 (including Government charges discussed in Note 21 above) amounted to SR 827 million and SR 4,685 million, respectively (2005: SR 673 million and SR 5,361 million, respectively).

Amounts payable to Government entities at December 31, 2006 totaled SR 792 million (2005: SR 1,255 million). Amounts receivable from Government entities at December 31, 2006 and 2005 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 12 million in favour of Arabsat with respect to satellite utilization (2005: SR 14 million), while expenses incurred in favour of the Arab Submarine Cables Co. approximated SR 4 million (2005: SR 6 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 696 million on December 31, 2006 (December 31, 2005: SR 367 million).

(b) Certain land and buildings, for use in the Company's operations, are leased under operating lease commitments expiring at various future dates. During the year 2006, total rent expense under operating leases amounted to SR 111 million (2005: SR 96 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, 2006 and 2005, as discussed below:

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

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

Commission rate risk

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

Currency risk

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

Credit risk

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

Within the framework of the telecom sector regulation, which resulted in significant changes in the identification and segmentation of the telecom services sectors, and due to increasing competition and the Company's strategic aim at raising the level of operational efficiency, the Company approved a new structure for its segments which differs from the current structure, thus requiring segmental information that differ significantly in their bases from the previous requirements.

32 REDUCTION IN SERVICE RATES

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

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 on what it considers affecting some of its rights.

34 SUBSEQUENT EVENTS

The Board of Directors, in its meeting of 4 Muharram 1428 H (January 23, 2007), proposed dividends for the fourth quarter of 2006 amounting to SR 3,000 million, at the rate of SR 1.50 per share, resulting in a total dividend for 2006 of SR 5.75 per share.

35 RECLASSIFICATION

Certain year 2005 accounting data have been reclassified to conform to the year 2006 classifications.

36 INTERIM FINANCIAL STATEMENTS (UNAUDITED)

Following are the quarterly income statements:

(Saudi Riyals in thousands)	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
	2006	2005	2006	2005	2006	2005	2006	2005
Total operating revenues	8,515,114	7,918,233	8,624,772	8,038,267	8,405,989	8,105,095	8,240,014	8,478,348
Total operating expenses	(5,049,316)	(4,605,797)	(5,150,528)	(5,115,826)	(5,271,331)	(4,389,410)	(5,666,569)	(5,066,857)
Operating income	3,465,798	3,312,436	3,474,244	2,922,441	3,134,658	3,715,685	2,573,445	3,411,491
Other income and expenses								
Cost of manpower improvement program	(125,000)	(352,456)	(125,000)	(56,048)	(125,000)	(55,700)	(125,000)	(55,699)
Commissions	126,650	41,391	86,985	41,153	102,155	51,100	100,823	73,630
Earnings from investments accounted for under the equity method	24,562	18,665	27,059	39,023	35,789	615	14,221	48,377
Other, net	5,215	60,767	19,189	24,610	151,853	(377,342)	298,832	(125,029)
Net income before zakat	3,497,225	3,080,803	3,482,477	2,971,179	3,299,455	3,334,358	2,862,321	3,352,770
Provision for zakat	(82,518)	(69,851)	(86,680)	(68,041)	(97,444)	(72,364)	(75,934)	(81,993)
Net income	3,414,707	3,010,952	3,395,797	2,903,138	3,202,011	3,261,994	2,786,387	3,270,777
Basic earnings per share in Saudi Riyals	1.71	1.51	1.70	1.45	1.60	1.63	1.39	1.64

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