

Management Discussion & Analysis Report – Year Ended 31/12/06

The management of Oman Telecommunications Company SAOG (Omantel) is pleased to present to the shareholders of the Company, a detailed report covering analysis on industry structure and development, opportunities and threats, future outlook, risks and concerns, detailed analysis on operational performance and other major activities of the year 2006.

BRIEF HISTORY:

Omantel is the leading telecom operator in the Sultanate providing Fixed, Mobile and Internet services to corporate, government and residential customers. The company was established in 1980 pursuant to Law No. 43 of 1980 as the General Telecommunications Organization (GTO), and has been a monopoly provider of telecommunications services since then. In view of emerging competition in the mobile market, Omantel Group established Oman Mobile in 2004, as a subsidiary company. Omantel became a publicly listed company in year 2005 and its shares were listed on July 28th, 2005 in the Muscat Securities Market (MSM). Omantel is currently owned 70 % by the government and 30 % by private investors.

The sector competition begun in March 2005 and the mobile segment was the first one to open up for competition.

INDUSTRY STRUCTURE & DEVELOPMENT:

Omantel's main operations are within the telecom market in Oman. The government started implementing the sector liberalization in line with World Trade Organization (WTO) agreement. Beginning March 2005, the industry witnessed competition in the mobile sector through the licensing of a 2nd mobile operator. Currently, two mobile operators have been licensed. The recent signing of Free Trade Agreement between Oman and USA, would accelerate the sector liberalization activities. The indications are that the Internet and Value Added services will be liberalized soon followed by Fixed Telephony services.

In view of the above, the management has already initiated steps to prepare for this evolving competitive scenario and has appointed the renowned international consultant to assist the management in this process.

OPPORTUNITIES AND THREATS:

With Fixed Business services set to open up for competition in year 2007, the telecom market in Oman would undergo further dynamic changes in telecom service offerings. New Internet and other Value Added service providers are expected to enter the market soon. This would provide the market with numerous differentiated service offerings that are not available at present. We realize that there are still opportunities to increase customer base and penetration levels in Oman. As the leading telecommunication service provider in Oman, Omantel Group is strongly placed not only to compete with newcomers in the fixed line business segment, but also to benefit from the same through providing wholesale services to new telecom operators. This is due to strong national brands, fully built-out and up-to-date network, and capable workforce in development,

national distribution as well as systems and processes efforts to provide and deliver services and support customers.

Though, liberalization would further stimulate the telecom market, and as witnessed in other markets under liberalization, the likely price dilution would impact the sector profitability significantly. Also, we are of the opinion that the number of operators in services such as Internet and Value added services are required to be adequately regulated to ensure profitable existence and service continuity. Omantel takes the view that competition is beneficial but that it needs to be implemented in the right market at the right time and under the right terms and conditions. We anticipate that the TRA's sector policy would provide the balanced path to further liberalization programs based on the current adopted way of consulting with the market players before finalizing the policy.

Finally, competition also provides Omantel with the opportunity to position itself as “**carrier of carriers**” on the basis of its unique network position, thus utilizing the evolving competition to further its business opportunities.

ANALYSIS OF SEGMENT AND PRODUCT WISE PERFORMANCE:

Total service revenues comprise revenues from Fixed line, Internet & data, Mobile services and in-payment and interconnection services. Total service revenues have increased from RO 270.6 million in 2005 to RO 323.6 million in 2006 (y-o-y growth of 19.6%).

The following table describes the classification of revenues for the past three years:

Financial year ended 31 December			
Fig in RO Mn	2004	2005	2006
Fixed line service (including payphones)	79.4	66.2	60.8
Internet and data services	13.9	18.7	22.0
Mobile Service	146.0	163.0	195.7
Others (In payment + Interconnection+ capacity sale)	8.2	22.8	45.1
Total Service Revenues	247.4	270.6	323.6
Growth %	17.2%	9.4%	19.6%

The growth in total service revenues in the period from 2004 to 2006 has been mainly driven by the increase in mobile revenue resulting from an increase in the number of mobile (and in particular prepaid) subscribers. Fixed line revenues fell during the same period. Aggregate internet and data communications revenue gradually rose during the same period. The increase in other revenue for the year 2006 is mainly due to interconnection service provided to the new mobile operator and new revenue stream realized from selling network capacity to international operators.

Segment Revenue

Fixed Line Services:

Fixed line services include national and international fixed line voice, prepaid cards (Jibreen) and payphones (Al Multaqa).

The ARPU for the fixed line segment has been derived based on the revenues generated by all fixed line users, including payphones.

Financial year ended 31 December			
	2004	2005	2006
Fixed line revenue (RO Million)	79.4	66.2	60.8
Average number of subscribers (including pre-paid & payphones services)	241,578	256,107	271,761
Blended Monthly ARPU (RO)	27.4	21.5	18.6

The ARPU of the fixed line segment has declined from RO 27.4 per month in 2004 to RO 18.6 per month in 2006. During the same period, the increase in number of average subscriber base is 6%.

Internet and Data Services

Internet and Data communications services include Internet dialup, Internet broadband services (ADSL "PowerNet"), Internet prepaid services ("Al Ufuq"), and Internet dedicated services and data services (domestic and international leased line).

The ARPU for the Internet services (excluding data services) has been derived based on the revenues generated by all Internet services, which includes dial-up, pre-paid, dedicated and ADSL services:

Financial year ended 31 December			
	2004	2005	2006
Internet revenues (RO millions)	7.7	10.7	13.3
Average Internet subscribers (including broadband)	58,314	72,689	89,587
Average revenue per subscriber per month blended (RO)	11.03	12.3	12.3

The above table demonstrates that the ARPU remain same in spite of increase in total internet revenues. This is mainly due to the increasing broadband subscriber base, which prevents dilution of overall ARPU of internet services.

Mobile Services

Mobile service includes postpaid, prepaid and other value added services. The year 2006 witnessed steady growth in mobile subscriber base and the Pre-Paid subscriber base has crossed the 1 Million mark.

The Omantel Group's mobile revenues have overtaken that of fixed line revenues and accounted for 61% of total revenues in 2006. The mobile segment has been the primary growth driver of the Omantel Group's revenues over the past 3 years.

The blended mobile ARPU (postpaid and prepaid) decreased from RO 17.4 in 2004 to RO 14.0 in 2006. The fall in the ARPU level is as expected as prices have been reduced and the numbers of subscribers have increased rapidly. However, the fall in blended ARPU in year 2006 is only

marginal (2%) over year 2005 and this performance is quite healthy considering the existing competitive scenario. The evolution of blended ARPU is provided in the following table:

Financial year ended 31 December			
Postpaid and Prepaid	2004	2005	2006
Mobile Revenue (RO millions)	146.0	163.0	195.7
Average subscribers	699,867	947,817	1,167,725
Blended Monthly ARPU (RO)	17.4	14.3	14.0

OUTLOOK:

Omantel has a strategy focusing on profitable growth which involves efforts to grow revenues as well as to contain costs. This strategy has proven effective in achieving growth in revenues as well as profits for the year 2006. For the subsequent period, Omantel will focus on:

- Growing in the mobile market, addressing opportunities relating to infrastructure and tourism industries and protecting revenue basis in fixed line
- Reducing cost basis through rightsizing efforts, realizing synergies as a Group and prudent cost management
- Upgrading capabilities in terms of network technologies and human resources
- Expand in telecom related business opportunities to extend Omantel's footprint whilst building business development capabilities

We expect the growth in the telecom market to continue in Oman and the group revenue would grow next year mainly due to additional growth opportunities in the mobile market. Retaining market share in a competitive environment would be a key challenge, though the company has done exceptionally well in terms of revenue and profitability growth in year 2006. However, it is difficult to repeat the current growth trend when the fixed business segment is liberalized. The group profits are expected to be stable as compared with last year due to growth opportunities in mobile but profitability is likely to be under pressure due to expected telecom price dilution resulting from competition. We foresee a major threat in the voice segment especially when the international voice segment is liberalized and the services, such as Voice over IP is formally permitted.

RISKS & CONCERNS

The major risks for the coming year mainly relate to the implementation of the sector liberalization program in Oman. With the expected liberalization of fixed telephony business segment, all telecommunication services will be fully liberalized. We are still not clear as to the path this would take as it's mainly dictated by the regulatory policies.

While expressing our concern on the sector liberalization, we repeat our view that *"it is vital that the liberalization policy is implemented in the right way, in the right market and at the right time to take into consideration the various stakeholders requirements"*. Omantel had initiated constructive dialogs with the TRA and we trust that the TRA will conduct adequate public consultations when it develops its perspective on the ways of further liberalizing the market.

Other concerns the management has, is the level of internal efficiency and competency that is required to face the competition, especially in the fixed telephony segment. Though, the management has implemented a series of programs to enhance the internal competencies, it may not have attained the required level to meet the competitive scenario, especially in activities related to customer service. The competitive framework requires different organizational capability to enhance the organization's competitive advantage. We are optimistic that our transformation programs, which are continuing at full pace would result in the required level of competency.

INTERNAL CONTROL SYSTEMS AND THEIR ADEQUACY:

The company has internal control systems and processes that provide reasonable assurance of effective and efficient operations, internal financial control and compliance with laws and regulations. Internal controls comprise of operational procedures, segregation of duties, periodic reconciliations and formal policies and procedures that facilitate complete, accurate and timely processing and recording of transactions and safeguarding of assets. The Management receives independent feedback from the reports issued by Internal Audit of the Group, Statutory Auditors and the State Audit Institution on the adequacy of the internal controls and endeavors to strengthen the internal control weaknesses. Also, as part of the internal control, the company has a defined authority manual and processes, which are followed across the organization. Internal controls are generally adequate for established activities and services. For new activities and services, certain inadequacies have been identified that are being addressed. Internal controls are periodically tested, reviewed and enhanced.

The recently implemented organization wide Enterprise Resource Planning (ERP solution based on Oracle e-suite) had established best practice guidelines designed to communicate controllable work flow according to approved authority manuals incorporating the Finance and Human Resource manuals. Control activities are set to identify risks and facilitate the audit trail by using comprehensive tracking, testing, and audit management capabilities, which will help to reduce the risk of both malfeasance and accidental errors.

FINANCIAL AND OPERATIONAL PERFORMANCE DURING 2006

The total group revenue as of Dec'06 rose by 20% to RO. 323.6 million compared to the corresponding period of the previous year.

The **Group's Net profit after tax** (NPAT) is RO 81.1 Million, an increase of 19% compared to the previous period. The Earning per Share (EPS) as of Dec'06 is RO 0.108. Summary of Profit & Loss account is given below.

Financial year ended 31 December			
Fig in RO Mn	2004	2005	2006
Revenue	247.4	270.6	323.6
Operating Expenses	167.9	193.8	230.0
Operating Profit	79.5	76.8	93.6
Profit before Taxation	82.7	77.8	92.1
Net Profit after Taxation (NPAT)	72.9	68.1	81.1

Operating Expenditure

Total operating expenses (“Opex”) of the Omantel Group amounted to RO 230.0 million in 2006, an increase of 19% compared to last year. As a percentage of total service revenue, Opex was 71.1% in year 2006, while the ratio in year 2005 was 71.6%. The following table sets out the breakdown of the components of Opex.

Financial year ended 31 December			
Fig in RO Mn	2004	2005	2006
Staff costs	27.9	30.2	34.2
Operating & maintenance expenditures	17.1	18.7	20.8
Administrative expenditures	6.1	7.9	6.4
Marketing & Advertising expenses	2.7	5.9	4.3
Sales Commissions	11.2	11.4	16.5
Provision for doubtful debts	6.7	5.7	5.0
Total Controllable Opex	71.7	79.8	87.2
Cost of content services	0.2	2.8	1.3
Cost of Roaming operator	2.4	4.5	4.6
External Administration expenses	12.8	16.3	16.7
Interconnection expenses	0.0	3.9	14.1
Depreciation	44.7	52.3	64.5
Provision for against penalties	0.0	1.7	0.0
Amortization of license fee	2.5	2.8	2.8
Annual License Fees to TRA	1.9	0.6	1.4
Royalty charges	31.7	29.1	37.4
Total Other Expenses	96.2	114.0	142.8
Total Operating Expenses	167.9	193.8	230.0

Staff Costs

Staff costs include salaries and allowances, social security costs, end of service benefits, and other benefits. Though the total number of permanent employees have decreased from 2,635 (Dec’05) to 2,583 as of Dec’06, the increase in staff costs is primarily related to the reorganization exercise and the establishment and development of autonomous Mobile operation.

Marketing, Operating & Maintenance and Administrative expenditures

Marketing and administrative expenses have recorded considerable decrease compared to last year. Total reduction from both accounts amounted to RO 3 million. Operating & Maintenance (“O&M”) expenditures have increased by 11%, which are in line with the network expansions carried out since 2003.

Collection and Sales Commissions

This comprises of commission (factoring) paid to OIFC at a rate of 3.5% of the total billing and commission charges paid to dealers for the sale of pre-paid cards. The increase in collection and

sales commission in 2006 is principally due to the increase in commissions resulting from increased sales of prepaid "Hayyak" cards, which witnessed an increase in sales of 37% compared to the corresponding period.

Royalty charges

With effect from 2004, the Omantel Group is required to pay a royalty amounting to 10% of gross revenues under the Fixed License and 12% of gross revenues under the Mobile License. An amount of RO 37.4 million has been provided by the Group as royalty charges for 2006.

Profitability

EBITDA / EBIT / Net Profit Margin

Financial year ended 31 December			
	<u>2004</u>	<u>2005</u>	<u>2006</u>
EBITDA	126.7	131.9	160.9
Net Profit after Taxation (NPAT)	72.9	68.1	81.1
Net Profit Margin	29%	25%	25%
EBITDA	51%	49%	50%
EPS	0.971	0.090	0.108

Note: EPS for the year 2004 is calculated based on 75 Mn shares of RO 1 per share, whereas in year 2005 onwards, the base is 750 Mn shares of RO 0.100 per share.

Cash Flow

The following table provides information regarding the Omantel Group's consolidated cash flows for the past three years:

Financial year ended 31 December			
	<u>2004</u>	<u>2005</u>	<u>2006</u>
Cash flow from Operating activities	161.5	116.7	158.1
Cash and cash equivalents at the end of the year	78.8	47.6	54.8

The Omantel Group's primary source of liquidity is cash generated from operations. Over the past 3 years, the Omantel Group has generated sufficient cash from operating activities to meet its working capital and capital expenditure requirements.

Balance Sheet

Total Assets

The total assets of the Omantel Group have, over the past 3 years, increased, reflecting the capital investments that the Omantel Group has incurred to upgrade and expand its network especially in the mobile and fixed line services. The fixed assets, principally telecom equipment and facilities now accounts for 78% of the total assets. An analysis of assets and liabilities are provided in the table below:

Financial year ended 31 December			
Fig in RO Million	2004	2005	2006
Current Assets	102.6	88.1	100.7
Non-current Assets	338.4	366.4	356.6
Total assets	441.0	454.5	457.3
Current Liabilities	141.7	145.2	155.0
Non-current Liabilities	34.6	55.4	20.1
Total Liabilities	176.3	200.6	175.1
Ratios			
Debt Ratio (Total liabilities/ Total assets)	40%	44%	38%
Current Assets / Current liabilities (Current ratio)	72%	61%	65%

The non-current assets of the Omantel Group mainly comprise of fixed assets and investment in associated companies (OFOC, Info-Line LLC, and Tejari).

The total liabilities of the Omantel Group decreased from RO 200.6 million in 2005 to RO 175.1 million in 2006. The largest portion of the Omantel Group's liabilities are owed to the Government in relation to dividends declared but not yet distributed as well as the reclassification of the Super Dividend into a long-term loan repayable over a 5-year term. As a percentage of total liabilities, amounts owed to the Government in the form of dividend, loan repayments, taxation and royalty charges accounted for 64% of total liabilities in 2006.

MAJOR ACTIVITIES DURING THE YEAR 2006

Omantel management is fully dedicated in its efforts to transform itself into a customer focused, efficient and capable operator that meets the increasing requirements of its customers. Some of the major activities / achievements of the year 2006 are summarized below:

Investment in Telecom infrastructure: During the year 2006, the company has signed over RO 32 Million worth of contracts, mostly infrastructure based expansion covering both Omantel and Oman Mobile.

National E-Government and BankNet project: These projects are next generation network services based on the latest Multi Protocol Label Switching (MPLS) technology. This innovative managed network service will have the capability of supporting data, voice and video over the same infrastructure and will ensure service delivery according to defined and guaranteed Service Level Agreements (SLA). Omantel signed an agreement with Information Technology Authority (ITA) for the establishment of e-government network and with Central Bank of Oman (CBO) for the establishment of BankNet network. While, these agreements would provide integrated telecommunication solutions, they would also support diverse needs of telecommunication requirements of each of these entities

Wireless Fixed phone lines service (WLL): First phase of the service was launched on 25th March 2006 covering 25 rural villages in the Government of Dhofar. The project is expecting to cover 200 rural villages over two phases, providing telecommunication facilities to remote populations.

WiFi (Hotspot) Service: The service was launched on 27th March 2006 under the brand name "Ibhar". The service is available in over 12 locations comprising of major shopping malls, coffee shops and hotels.

Memorandum of Understanding with Flag Telecom Company: Omantel signed a Memorandum of Understanding on 25/6/2006 with FLAG Telecommunications Company. This will make the Sultanate an Internet transit point between the Middle East and Africa.

Pakistani Trans World Associates (TWA): Omantel and the leading Pakistani Trans World Associates (TWA) Telecommunications Company launched submarine fiber optics cable project on 28th July 2006, which will provide a telecommunication link between Oman and Pakistan. The TWA project is one of the successes of the Falcon project, as it will enable Omantel to sell some of its vast cable capacities.

Omania E-Commerce Company (Tejari Oman): Omantel announced the signing of an agreement with Omania E commerce company (Tejari Oman) to provide electronic purchase solutions known as "Tejari Transact". This is a set of commercial solutions over the Internet, which guarantees flexibility and transparency as well as reduces purchasing costs.

Belgacom International Carrier Services: Omantel has signed a MOU on 22nd November 2006 with Belgacom International Carrier Services, which would establish the framework for a partnership that will further develop respective international carrier services. The MOU will form the basis of a cooperation deriving mutual benefit of both operators' complimentary strengths, with the aim to be amongst the top providers of international wholesale services within the Middle East.

Telecommunication backbone service to Petroleum Development Oman (PDO): Omantel signed a long term contract for the provision of Telecommunication Backbone service to PDO for the total amount of RO 12 Mn covering a period of over 11 years.

Telecommunication backbone service to Ministry of Information (MoI): The Tender Board has awarded a contract to Omantel to provide terrestrial links for TV transmission for the MoI at a total amount of RO 1.4 Mn per annum.

Mobile Number Portability (MNP): Mobile Number Portability (MNP) was introduced on the 26th of August 2006 by both Mobile operators (Oman Mobile and Nawras). This was implemented as part of the directive from the Telecommunication Regulatory Authority, which would allow customers to switch to other mobile operators without changing their numbers.

Gulf Economic Award: Omantel won the 2006 Gulf Economic Award organized by Dubai-based Datamax Company. The award is granted annually to the best organization and institutions which play a positive role in supporting the Gulf economy, attracting foreign investment and realizing good practical results through sound management and leadership.

Deals of the Year Award: Omantel won the "Deals of the Year" award from the British magazine (The Banker). Omantel was selected amongst other Omani companies on the basis of the largest IPO in Oman, in addition to the company's strong appeal amongst smaller investors.

Oman Economic Review Acknowledgment: Omantel has been acknowledged as the number one publicly listed company in the Sultanate of Oman by Oman Economic Review, Oman's leading business magazine. The OER Top 20 Rankings are based on revenues, profit, and market capitalization for the period 2005.

5th Gulf Excellence Award: Omantel was presented with the "Gulf Excellence Award" for their outstanding accomplishments for playing active role in the economic diversification drive.

Awards for Oman Mobile: The mobile business has also been recognized in 2006 with following awards:

- 1) The "New Telecoms Service of the Year" of the Middle East and Africa Region for SMS Parking (event organized by CommsMEA).
- 2) The Network Middle East Innovation Award for "Best Wireless Network Implementation in the Middle East".
- 3) Award for Distinction in Offering Vocational Training to National Cadre at the GCC Level.

MARKETING ACTIVITIES:

The year 2006 was filled with series of marketing activities with onslaught of competition which included price revisions, new product / service launches and innovative value for money consumer promotions, special offers for both fixed and mobile businesses. Some of the major marketing activities are highlighted below:

Mobile Business:

Post-paid service: Major offers during the year were - Reduction of SIM Card fee from RO 7 to RO 2 and the cancellation of the activation which used to be RO 10. In August 2006 new tariffs for Mada were introduced. The new off-peak rate is as low as 24 bz per minute.

Pre-paid service: Major offers during the year were - Reduction of starter kit price from RO 14 to RO 10 with special promotions on a few occasions where the price was slashed to RO 7 and attractive bundled offers with handsets. Special promotions of an additional 20% talk time with RO 10 Hayyak recharge vouchers.

Launch of series of SMS / MMS based infotainment and other services: The mobile business has endeavored to deploy new, customer oriented products to simplify people's life and enhance their mobile experience with services such as OM chat, Money Transfer, SAWA (Twin SIM Service), MMS International, Sports Goal with the auspices of the Ministry of Sports, payment gateway to all mobile subscribers to Ibhara WiFi, Mobile Number Portability, International Roaming agreements with more than 290 operators in 116 countries, and more than 80 agreements with TV stations from the MENA region for SMS based services.

Fixed Business:

Special consumer promotions with attractive offers for fixed line services, internet with PC bundle offers, Broadband (ADSL) service, free surfing hours etc., were offered during Muscat / Khareef Festival, Comex'06 and Ramadhan. Special Fixed Line additional services were offered to subscribers free of costs: callers ID, call waiting, follow me, three party conversation, and

automatic call transfer (Self Hunting). This is a marvelous service as one can transfer calls to a vacant number from a specific group of number when the subscriber's phone is busy. Also, FIFA World Cup offers where 12 winners were given fully paid tickets to the World Cup.

Sponsorships:

Omantel as a group actively supports sport, education and special needs organizations. Omantel as a corporate citizen takes its social responsibility towards development of Oman seriously. It has sponsored various educational events for the Ministry of Education, SQU and Nizwa University to name a few. Omantel helps the Ministry of Education to communicate the high school examination results through SMS. Omantel sponsored and hosted the meetings of the Board of Directors and the General Assembly of Arabsat as well as the 8th Arab Telecommunications and the Internet Forum here in Muscat in the month of May 2006.

Dr. Mohammed Ali Al Wohaibi
Chief Executive Officer