

TELECOM ITALIA S P A
Form 20-F
May 19, 2006
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

.. REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (g) OF THE SECURITIES EXCHANGE ACT OF 1934
OR

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended: December 31, 2005

OR

.. TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from N/A to N/A

OR

.. SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Date of event requiring this shell company report

Commission file number: 1-13882

Telecom Italia S.p.A.

(Exact name of Registrant as specified in its charter)

Italy

(Jurisdiction of incorporation or organization)

Piazza degli Affari 2, 20123 Milan, Italy

(Address of principal executive offices)

Securities registered or to be registered pursuant to Section 12(b) of the Act:

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
American Depositary Shares, each representing 10 Ordinary Shares of 0.55 par value each	The New York Stock Exchange
Ordinary Shares of 0.55 par value each (the Ordinary Shares)	The New York Stock Exchange*
American Depositary Shares, each representing 10 Savings Shares of 0.55 par value each	The New York Stock Exchange
Savings Shares of 0.55 par value each (the Savings Shares)	The New York Stock Exchange*

Securities registered or to be registered pursuant to Section 12(g) of the Act:

None

(Title of Class)

Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:

None

(Title of Class)

Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the period covered by the annual report.

Ordinary Shares 13,244,665,769

Savings Shares 6,026,120,661

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934. Yes No

Note: Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

Indicate by check mark which financial statement item the registrant has elected to follow. Item 17 Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

* Not for trading, but only in connection with the registration of American Depositary Shares representing such Ordinary Shares or Savings Shares, as the case may be, pursuant to the requirements of the Securities and Exchange Commission.

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Introduction

INTRODUCTION

Telecom Italia S.p.A. is incorporated as a joint stock company under the laws of Italy. As used in this Annual Report, unless the context otherwise requires, the term Company means Telecom Italia S.p.A. the operating company for fixed and mobile telecommunications services in Italy and the holding company for various businesses, principally telecommunications, and the terms we, us and our refers to the Company, and, as applicable, the Company and its consolidated subsidiaries.

Unless otherwise indicated, the financial information contained in this Annual Report has been prepared in conformity with International Financial Reporting Standards as adopted by the European Commission for use in the European Union (**IFRS**), which, as described in Note 43 Reconciliation of IFRS as adopted by the EU to U.S. GAAP of the Notes to the Consolidated Financial Statements, differ in certain material respects from generally accepted accounting principles in the United States (**U.S. GAAP**). Unless otherwise indicated, any reference in this Annual Report to Consolidated Financial Statements is to the Consolidated Financial Statements of the Telecom Italia Group (including the notes thereto) included elsewhere herein.

Telecom Italia adopted IFRS for the first time in its annual Consolidated Financial Statements for the year ended December 31, 2005, which included comparative financial statements for the year ended December 31, 2004. IFRS 1, *First-time Adoption of International Financial Reporting Standards*, requires that an entity develop accounting policies based on the standards and related interpretations effective at the reporting date of its first annual IFRS financial statements (i.e., for Telecom Italia, December 31, 2005). IFRS 1 also requires that those policies be applied as of the date of transition to IFRS (i.e., for Telecom Italia, January 1, 2004) and throughout all periods presented in the first IFRS financial statements. See Item 5. Operating and Financial Review and Prospects 5.4 Adoption of International Financial Reporting Standards, and Note 42 Transition to International Financial Reporting Standards (IFRS) of the Notes to the Consolidated Financial Statements.

Cautionary Statement for Purposes of the Safe Harbor Provisions of the United States Private Securities Litigation Reform Act of 1995. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. This Annual Report contains certain forward-looking statements, including, but not limited to, the discussion of the changing dynamics of the marketplace, including the continuing developments in competition in all aspects of our businesses from new competitors and from new and enhanced technologies, our outlook for growth in the telecommunications industry both within and outside of Italy, including our outlook regarding developments in the telecommunications industry, including certain trends we have identified particularly in our core Italian market, continuing regulatory measures regarding pricing and access for other local operators. Such statements include, but are not limited to, statements under the following headings: (i) Item 3. Key Information 3.1 Risk Factors, (ii) Item 4. Information on the Telecom Italia Group 4.1 Business 4.1.3 Significant Developments During 2005 and 4.1.8 Updated Strategy, (iii) Item 4. Information on the Telecom Italia Group 4.3 Regulation, (iv) Item 5. Operating and Financial Review and Prospects, (v) Item 8. Financial Information 8.3 Legal Proceedings and (vi) Item 11. Quantitative and Qualitative Disclosures About Market Risks, including statements regarding the likely effect of matters discussed therein. Actual results may differ materially from those projected or implied in the forward-looking statements. Such forward-looking information involves risks and uncertainties, which are outside our control, that could significantly affect expected results and are based on certain key assumptions.

The following important factors could cause our actual results to differ materially from those projected or implied in any forward-looking statements:

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- the continuing impact of increased competition in a liberalized market, including competition from global and regional alliances formed by other telecommunications operators in our core Italian domestic fixed-line and wireless markets;
- our ability to introduce new services to stimulate increased usage of our fixed and wireless networks to offset declines in the traditional fixed-line voice business due to the continuing impact of regulatory required price reductions, market share loss, pricing pressures generally and shifts in usage patterns;
- the level of demand for telecommunications services, particularly wireless telecommunications services in the maturing Italian market and for new higher value added products and services such as broadband;

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- our ability to achieve the planned synergies expected to be generated by the merger of Telecom Italia and TIM, including in expenses, capital expenditures and capacity to launch new convergent services;
- the success of our customer loyalty and retention programs and the impact of such programs on our revenues;
- the impact of regulatory decisions and changes in the regulatory environment, including implementation of recently-adopted EU directives in Italy;
- our ability to successfully implement the new structure following the Telecom Italia and TIM merger;
- the impact of economic development generally on our international business and on our foreign investments and capital expenditures;
- the continuing impact of rapid or disruptive changes in technologies;
- the impact of political and economic developments in Italy and other countries in which we operate;
- the impact of fluctuations in currency exchange and interest rates;
- our ability to successfully implement our strategy over the 2006-2008 period;
- our ability to successfully achieve our debt reduction targets;
- our ability to successfully implement our Internet and broadband strategy both in Italy and abroad;
- our ability to achieve the expected return on the investments and capital expenditures we have made and continue to make in Brazil and in Europe on broadband;
- the amount and timing of any future impairment charges for our licenses, goodwill or other assets; and
- the impact of litigation or decreased mobile communications usage arising from actual or perceived health risks or other problems relating to mobile handsets or transmission masts.

The foregoing factors should not be construed as exhaustive. Due to such uncertainties and risks, readers are cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date hereof. We undertake no obligation to release publicly the result of any revisions to these forward-looking statements which may be made to reflect events or circumstances after the date hereof, including, without limitation, changes in our business or acquisition strategy or planned capital expenditures, or to reflect the occurrence of unanticipated events. See Item 3. Key Information 3.1 Risk Factors and the related

cautionary statement under Item 5. Operating and Financial Review and Prospects .

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Key Definitions

KEY DEFINITIONS

The following terms appearing in this Annual Report have the meanings set forth below.

EU	means the European Union.
IFRS	means International Financial Reporting Standards, as adopted by the European Commission for use in the European Union.
Merger	means the merger of Old Telecom Italia into Olivetti, which became effective on August 4, 2003.
Mobile Italy	means the unit which operates our Italian mobile business.
Old Telecom Italia and Old Telecom Italia Group	means Telecom Italia and its consolidated subsidiaries as they existed immediately prior to the effective date of the Merger.
Olivetti	means Olivetti S.p.A., the holding company and controlling shareholder of Old Telecom Italia.
Olivetti Group	means Olivetti and its consolidated subsidiaries, including Old Telecom Italia.
Ordinary Shares	means the Ordinary Shares, 0.55 par value each, of Telecom Italia.
Savings Shares	means the Savings Shares, 0.55 par value each, of Telecom Italia.
Telecom Italia	means the entity which resulted from the Merger.
Telecom Italia Group	means the Company and its consolidated subsidiaries.
Telecom Italia Media	means the corporate name of the remaining part of Seat Pagine Gialle S.p.A., which resulted from the proportional spin-off of the directories and most of the directory assistance and business information business segments of SEAT into New SEAT. The spin-off became effective on August 1, 2003 and new SEAT was disposed of on August 8, 2003. Telecom Italia Media is the Telecom Italia Group's subsidiary operating in the Media business.

TIM means Telecom Italia Mobile S.p.A., the Telecom Italia Group's subsidiary which operated in the mobile telecommunications business, and merged with and into Telecom Italia, with Telecom Italia as the surviving company, effective as from June 30, 2005.

Tim Italia means the company deriving from the spin-off of TIM's domestic mobile assets, effective as from March 1, 2005. After the merger of TIM with and into Telecom Italia, Tim Italia became a wholly-owned subsidiary of Telecom Italia. Subsequently Tim Italia merged with and into Telecom Italia, with Telecom Italia as the surviving company, effective as from March 1, 2006. Tim Italia as used in this Annual Report refers to the unit (Mobile Italy) which operates our Italian mobile business.

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Item 2. Offer Statistics and Expected Timetable

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PART I

Item 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not Applicable

Item 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not Applicable

Item 3. KEY INFORMATION

3.1 RISK FACTORS

Strong competition in Italy may further reduce our core market share of domestic and international traffic and may cause further reductions in prices and margins.

Strong domestic competition exists in all of the principal telecommunications business areas in Italy in which we operate, including, most significantly, the fixed-line and mobile voice telecommunications businesses. The use of the single European currency and the liberalization of the Italian telecommunication market (since January 1998) have intensified competition by facilitating international operators' entry into the Italian market and direct competition with our fixed line and mobile telephony businesses, particularly in the local and long-distance markets. As of December 31, 2005, there were a number of significant competitors offering fixed-line services and four other operators (in addition to Mobile Italy) offering mobile services in the Italian domestic market. This competition may increase further due to the consolidation and globalization of the telecommunications industry in Europe, including Italy, and elsewhere. We anticipate that in the short to medium term there may be a stronger entry of peer-level international competitors into markets with existing operators, including Italy, increasing the direct competition we face in our Italian domestic fixed line and mobile telephony businesses and in the local and long-distance markets.

Although we have taken a number of steps to realize additional efficiencies and introduce innovative and value added services over our networks, and although our plans take into account that we will face significant competition from a number of operators in all

the markets in which we operate, continuing pressures on prices due to competition and further erosion in market shares could adversely affect our results of operations.

Our business may be adversely affected and we may be unable to increase our revenues if we are unable to continue the introduction of new services to stimulate increased usage of our fixed and wireless networks.

In order to sustain growth in revenues despite increased competition and lower prices, particularly in our core Italian domestic market, our strategy has been to introduce new services in our fixed-line and wireless businesses to increase traffic on our networks and find alternative revenue sources, in addition to carrying voice traffic on our networks.

These strategic initiatives have required and will continue to require substantial expenditures and commitment of human resources. Although these initiatives are core to our strategy, we may be unable to introduce commercially these new products and services, and even if we introduce them, there can be no assurance they will be successful.

Our business will be adversely affected if we are unable to successfully implement our organizational restructuring and strategic objectives. Factors beyond our control may prevent us from successfully implementing our strategy.

On March 1, 2006, we completed a significant reorganization. As part of the reorganization, our Italian mobile business was transferred to Telecom Italia by way of merger of Tim Italia into Telecom Italia. In addition, during 2005, all of our activities in the area of Internet, previously conducted by Telecom Italia Media, were also transferred to Telecom Italia.

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Item 3. Key Information

Risk Factors

On March 8, 2006, we presented to the investor community our strategic targets for the period 2006-2008, which were updated in light of our new organizational structure known as the One Company model. The One Company model is based on the following five pillars:

- convergence synergies: reaping synergies from lower costs and improved offerings by consolidating the offering of our main services (fixed line, mobile and internet) in one company;
- productivity and skills: increasing the productivity and skill-base of employees;
- advanced network deployment: deploying an innovative network infrastructure making possible the rapid deployment of next-generation products and services while safeguarding the continued improvement of the quality of services;
- loyalty and retention: strengthening customer loyalty through an upgraded customer care model and improved offering; and
- marketing leadership and growth: continued leadership in marketing, sustaining continued growth.

Our ability to achieve the strategic goals of the reorganization and our targets may be influenced by several factors, including without limitation:

- our ability to manage costs;
- our ability to attract and retain highly-skilled and qualified personnel;
- our ability to effectively integrate the Telecom Italia and TIM organization within the One Company model;
- our ability to achieve the synergies anticipated from the convergence of fixed communications, mobile communications and Internet;
- the effect of foreign exchange fluctuations on our results of operations;
- the entry of new competitors in the liberalized Italian telecommunications market and the other principal markets in which we operate, which may result in our losing market share in Italy and internationally;
- our ability to strengthen our competitive position through our focus on Brazil and Broadband in Europe based on our specialized skills and technical resources;

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- our ability to successfully develop and introduce new technologies to meet market requirements, to manage innovation, to provide value-added services and to increase the usage of our fixed and mobile networks;
- the need to establish and maintain strategic relationships;
- declining prices for some of our services and increasing competition;
- the effect of adverse economic trends on our principal markets; and
- the success of new disruptive technologies that could cannibalize fixed and mobile revenues.

There can be no assurance that our objectives will be effectively implemented in the planned timeframes.

Regulatory decisions and changes in the regulatory environment could adversely affect our business.

Our fixed and mobile telecommunications operations, as well as our broadband services businesses, are subject to extensive regulatory requirements in Italy and our international operations and investments are subject to regulation in their host countries.

As a member of the EU, Italy has adapted its telecommunications regulatory framework to the legislative and regulatory framework established by the EU for the regulation of the European telecommunications market. The EU Commission approved a new electronic communications framework in March 2002, which has been effective in Italy since September 2003. See Item 4. Information on the Telecom Italia Group 4.3. Regulation .

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Item 3. Key Information

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Included within this new framework is the obligation on the part of the Italian regulator responsible in Italy for the regulation of the telecommunications, radio and television broadcasting sector (the National Regulatory Authority or NRA) to identify operators with significant market power based on a market analysis in eighteen separate retail and wholesale markets, in which it is considered necessary to intervene to protect free competition. The new framework establishes criteria and procedures for identifying remedies applicable to operators with significant market power. The NRA is expected to complete and publish the analyses by mid 2006 and the implementation of these revised telecommunications regulations and possible future decisions relating thereto, may change the regulatory environment in a manner adverse to us, particularly if such analysis relates to new services which are not currently part of the eighteen identified markets.

In Italy, we are subject to universal service obligations, which require us to provide fixed line public voice telecommunications services in non-profitable areas.

In addition, the NRA has identified us as an operator having significant market power in most relevant markets. As a result, we are, and, if we continue to be identified as having significant market power in most relevant markets, will be, subject to a number of regulatory constraints, including:

- a requirement to conduct our business in a transparent and non-discriminatory fashion;
- a requirement to have our prices for fixed voice telephony services and Reference Interconnection Offer, the tariff charged to other operators to utilize our network, subject respectively to a price cap and a network cap mechanism. This cap mechanism places certain limits on our ability to change our prices for certain services; and
- a requirement to provide interconnection services, leased lines and access to the local loop to other operators at cost-orientated prices. These services include allowing other operators to connect to our network and transport traffic through the network as well as offering certain services related to our local access network, or local loop, on an unbundled basis to these other operators to enable these operators to directly access customers connected to the network by leasing the necessary components from us.

We are unable to predict the impact of any proposed or potential changes in the regulatory environment in which we operate both in Italy and internationally. Changes in laws, regulation or government policy could adversely affect our business and competitiveness. In particular, our ability to compete effectively in our existing or new markets could be adversely affected if regulators decide to expand the restrictions and obligations to which we are subject or extend them to new services and markets. Finally, decisions by regulators regarding the granting, amendment or renewal of licenses, to us or to third parties, could adversely affect our future operations in Italy and in other countries where we operate.

Changes in the rules relating to radio and televisions broadcasting could adversely affect the development of our activities in this field.

Please see Item 4. Information on the Telecom Italia Group 4.3. Regulation in this report for more information on the regulatory requirements to which we are subject.

We have impermissible overlapping licenses in Brazil.

Currently, we hold licenses in Brazil through our indirectly owned subsidiary, TIM Celular, to provide Personal Communications Services (PCS) services in Regions I, II and III of the PCS general licensing plan and to provide national and international long distance services. The Brasil Telecom Group (Brasil Telecom) also holds licenses in Brazil to provide PCS services in Region II of the PCS general licensing plan and to provide national and international long distance services. The Brazilian regulatory authority, Anatel, prohibits the provision of the same services, by the same legal entity, whether directly or indirectly, in the same Region. Since we also indirectly hold certain equity participations and governance rights in connection with Brasil Telecom, under the broad definition of the expression directly or indirectly Brasil Telecom may be viewed as our affiliate for regulatory purposes in Brazil. As a consequence, according to Anatel's rulings there currently exists an impermissible overlap between certain of the licenses held by TIM Celular and certain of the licenses held by Brasil Telecom (the Overlap).

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Risk Factors

Anatel has determined that the relevant entities of the Telecom Italia Group and Brasil Telecom should find a solution for such Overlap and has established that such solution should be reached within October 2006.

On April 28, 2005, TIM Brasil, Brasil Telecom, and certain other parties entered into an agreement intended to respond to the requests of Anatel to resolve the Overlap. The implementation of the agreement was prevented as a result of legal challenges initiated by some of the indirect co-shareholders of Brasil Telecom and by Brasil Telecom itself on various proceedings. It was terminated on April 29, 2006 in accordance with its terms. The relevant parties are continuing to seek a resolution to the Overlap to comply with Anatel's determinations. For more information, see Item 4. Information on the Telecom Italia Group 4.2.5 Other Telecom Italia Group Activities Brasil Telecom Group .

Absent a negotiated solution, upon expiration of the cure period set forth by Anatel (October 2006), Anatel itself will decide how to resolve the Overlap and the parties could be subject to penalties in accordance with the law. Such penalties could have a material adverse effect on the value of our investments in Brazil and our results of operations.

We may not achieve the expected return on our significant investments and capital expenditures made in our international activities due to the competitive environments in these markets.

In recent years, we have repositioned our international strategy, sold significant non-core international assets, and elected to focus our international strategy on:

- consolidating our international presence in Latin America, Europe and the Mediterranean Basin;
- developing our international investments in high-growth market segments, such as wireless, data and Internet (broadband);
- strengthening our role as a strategic partner in existing investments, by increasing the transfer of our technological expertise and marketing know-how; and
- rationalizing our existing international portfolio by divesting minority shareholding in non-strategic geographical markets.

Pursuant to our 2006-2008 plan we will continue to target our international investments in Latin America, particularly mobile telecommunications in Brazil, European broadband and mobile telecommunications in selected markets. These investments will continue to require significant capital expenditures and there can be no assurance that we will be able to achieve a satisfactory return on such international investments.

Continuing rapid changes in technologies could increase competition or require us to make substantial additional investments.

Many of the services we offer are technology-intensive and the development of new technologies may render such services non-competitive or reduce prices for such services. We make and will have to make substantial additional investments in new technologies to remain competitive. The new technologies we choose may not prove to be commercially successful. In addition, we may not receive the necessary licenses to provide services based on new technologies in Italy or abroad. Furthermore, our most significant competitors in the future may be new entrants to our markets who do not have to maintain an installed base of older equipment. As a result, we could lose customers, fail to attract new customers or incur substantial costs in order to maintain our customer base.

The value of our operations and investments may be adversely affected by political and economic developments in Italy or other countries.

Our business is dependent on general economic conditions in Italy, including levels of interest rates, inflation and taxes. A significant deterioration in these conditions could adversely affect our business and results of operations. We may also be adversely affected by political and economic developments in other countries where we have made significant investments in telecommunications operators. Some of these countries have political, economic and legal systems that are unpredictable. Political or economic upheaval or changes in laws or their application in these countries may harm the operations of the companies in which we have invested and impair the value of these investments. A significant additional risk of operating in emerging market countries is that foreign exchange restrictions could be established. This could effectively prevent us from receiving profits from, or from selling our investments in, these countries.

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Item 3. Key Information

Risk Factors

Fluctuations in currency exchange and interest rates may adversely affect our results.

In the past, we have made substantial international investments, primarily in U.S. dollars, and have significantly expanded our operations outside of the Euro zone, particularly in Latin America.

We generally hedge our foreign exchange exposure, but do not cover translation risk relating to our foreign subsidiaries. Movements in exchange rates of the Euro relative to other currencies (in particular, the Brazilian Real) may adversely affect consolidated results. A rise in the value of the Euro relative to other currencies in certain countries in which we operate or have made investments will reduce the relative value of the revenues or assets of our operations in those countries and, therefore, may adversely affect our operating results or financial position.

In addition, we have risen, and may raise in an increasing proportion in the future, financing in currencies other than the Euro, principally the U.S. dollar and British Pound. We systematically hedge the foreign currency risk exposure relating to non-Euro denominated liabilities, through cross-currency and interest rate swaps.

Mainly as a result of the need to finance Telecom Italia's Cash Tender Offer for ordinary and savings shares of TIM, completed in January 2005, the total gross debt of the Telecom Italia Group and corresponding interest payments increased. Our total gross financial debt as of December 31, 2005 was 52,101 million (43,313 million at year end 2004). At the end of 2005, approximately 34% of our gross financial debt carried a floating interest rate compared to approximately 30% at the end of 2004.

We enter into derivative transactions to hedge our interest exposure and to diversify debt parameters in order to reduce debt cost and volatility within predefined target boundaries. However, no assurance that fluctuations in interest rates will not adversely affect our results of operations can be given.

The mobile communications markets have matured in recent years and competition has increased.

In recent years, our consolidated revenues have grown or remained stable in large part because of the rapid growth in the mobile communications business which has offset substantially flat revenues in our Italian fixed line business. However, as a result of this growth, the mobile communications markets are approaching maturity levels in the voice services segment while the data and value-added services segments are growing.

We have acquired a third generation mobile telephone, or UMTS, license to provide UMTS services in Italy for 2,417 million and have made significant investments, in accordance with the terms and conditions of our licenses, to create the infrastructure to offer UMTS services. We commenced offering UMTS services in Italy in the second half of 2004 and have made in 2005, and will have to continue to make in the future, significant investments in promotional activities relating to our UMTS services. Given the substantial costs of upgrading our existing networks to support UMTS, the ongoing costs to market and support these new services, and the significant competition among operators who offer these new services, including one operator only offering 3G

services, we may not be able to recoup our investments, as planned if at all.

Continued growth in the mobile telecommunications markets in which we operate will depend on a number of factors, many of which are outside our control. These factors include:

- the activities of our competitors;
- competitive pressures and regulations applicable to retail and wholesale prices;
- the development and introduction of new and alternative technologies for mobile telecommunications products and services and their attractiveness to customers;
- the success of new disruptive or substitutive technologies; and
- the development of the mobile communications markets.

If the mobile telecommunications markets in which we operate do not continue to expand, or we are unable to retain our existing customers or stimulate increases in customer usage, our financial condition and results of operations may be harmed.

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Risk Factors

We may be adversely affected if we fail to successfully implement our Internet and broadband strategy in Italy and internationally.

The introduction of Internet and broadband services is an important element of our growth strategy and means to increase the use of our networks in Italy and expand our operations outside of Italy, particularly in Europe. Our strategy is to replace the mature, traditional voice services with value added content and services to consumers and small and medium-sized companies. Our ability to successfully implement this strategy may be affected if:

- Internet usage in Italy grows more slowly than anticipated, for reasons such as changes in Internet users' preferences;
- broadband penetration in Italy and other European countries does not grow as we expect;
- competition increases, for reasons such as the entry of new competitors, consolidation in the industry or technological developments introducing new platforms for Internet access and/or Internet distribution or other operators can provide broadband connections superior to those that we can offer; and
- we experience any network interruptions or related problems with network infrastructure.

Outside of Italy our ability to implement this strategy will depend on whether we are able to acquire assets or networks or utilize networks of incumbent operators that will allow us to offer such services.

Any of the above factors may adversely affect the successful implementation of our strategy, our business and results of operations.

As a result of the Merger, the cash tender offer for TIM shares and the merger of TIM into Telecom Italia, we remain highly leveraged.

Our gross financial debt was 52,101 million at December 31, 2005 compared with 43,313 million at December 31, 2004, and our total net financial debt was 39,858 million as of December 31, 2005 compared with 32,862 million at December 31, 2004. See Item 5. Operating and Financial Review and Prospects 5.5 Results of Operations for the Two Years Ended December 31, 2005 5.5.2. Non-GAAP Financial Measures, which reconciles our net financial debt to the gross financial debt. The increases in gross and net financial debt were mainly due to the Cash Tender Offer for the TIM shares.

Our goal is to further reduce our net financial debt during 2006 through significant cash flow generation. Factors beyond our control, including but not limited to, deterioration in general economic conditions, could significantly affect our ability to generate cash to reduce debt or to refinance existing debt through further borrowing.

The management and further development of our business require the implementation of significant investments plans. We may therefore incur additional debt or refinance existing debt taking advantage of conditions on financial markets. Our future results of operations may be influenced by our ability to enter into such transactions, which is in turn determined by market conditions and external factors.

Actual or perceived health risks or other problems relating to mobile handsets or transmission masts could lead to litigation or decreased mobile communications usage.

Various reports have alleged that certain radio frequency emissions from wireless handsets and transmission equipment may be linked to various health concerns and may interfere with various electronic devices. We cannot rule out that exposure to electromagnetic fields or other emissions originating from wireless handsets will not be identified as a health risk in the future. Our mobile communications business may be harmed as a result of these alleged health risks. For example, the perception of these health risks could result in a lower number of customers, reduced usage per customer or potential consumer liability.

In addition, although Italian law already requires strict limits in relation to transmission equipment, these concerns may cause regulators to impose greater restrictions on the construction of base station towers or other infrastructure, which may hinder the completion of network build-outs and the commercial availability of new services and may require additional investments.

Table of Contents**Item 3. Key Information****Risk Factors*****Risks associated with Telecom Italia's ownership chain.***

Although, as a result of the Merger, no shareholder controlled Telecom Italia, because of the voto di lista system for the election of directors, currently 14 out of 21 of Telecom Italia directors (of whom 13 are considered independent) were elected from a slate of candidates proposed by Olimpia, which is currently the largest shareholder in Telecom Italia with an interest of approximately 18%. Please see Item 4. Information on the Telecom Italia Group 4.1. Business 4.1.1 Background.

In addition, Marco Tronchetti Provera and Carlo Orazio Buora, respectively Chairman and co-Chief Executive Officer of Telecom Italia, are also, respectively, Chairman and Managing Director of Pirelli & C. S.p.A., which currently owns a 57.66% stake in Olimpia. Such stake may increase as a result of certain Olimpia shareholders exercising their rights under the Olimpia Shareholders' Agreements. Please see Item 7. Major Shareholders and Related-Party Transactions 7.1 Major Shareholders 7.1.1 The Olimpia Shareholders' Agreements. Mr. Tronchetti Provera is Chairman of Olimpia, and Mr. Buora is a member of Olimpia's board of directors. Please see Item 6. Directors, Senior Management and Employees 6.1 Directors 6.1.1 Biographical Data for more information.

Although Olimpia does not and will not own a controlling interest in Telecom Italia voting shares, Olimpia may exert a significant influence on all matters to be decided by a vote of shareholders. In addition, as a result of its proposal of a majority of the present Telecom Italia Board members, Olimpia may be able to influence certain corporate actions. In principle, the interests of Olimpia in deciding shareholder matters could be different from the interests of Telecom Italia's other Ordinary Shareholders, and it is possible that certain decisions could be taken that may be influenced by the needs of Olimpia.

Olimpia is in effect a holding company and the sole full operating company in which it holds shares is Telecom Italia. Therefore, if Olimpia were unable to obtain additional funding from new or existing shareholders or from other sources, Olimpia would be entirely dependent on dividends paid on its Telecom Italia shares for its funding needs, including to reimburse its existing debt. Under such circumstances, among the Telecom Italia corporate decisions that could be influenced by the needs of Olimpia would be the level of dividends payable by Telecom Italia to its shareholders.

Telecom Italia's financial position is not directly related to Olimpia and as such Telecom Italia does not have any obligations with respect to such debt since they are separate legal entities. Notwithstanding the foregoing, since certain rating agencies view Olimpia's and Telecom Italia's financial position together, such a view could affect our debt ratings, which may adversely affect Telecom Italia's financial flexibility and its cost of capital.

Although no shareholder controls Telecom Italia and thus is in a position to prevent a takeover of Telecom Italia, the Italian State, through the Treasury, is in a position to exert certain powers with respect to Telecom Italia through the exercise of the special powers included in Telecom Italia's Bylaws pursuant to compulsory legal provisions: specifically the so-called Golden Share still provides for the Italian State's authority to oppose the acquisition of material interests in our share capital (which is defined as 3% of the voting share capital). Currently, the exercise of special powers by the Italian State with respect to privatized companies (including Telecom Italia) is governed by ad hoc rules, but it is possible that the Italian State's Golden Share could make a merger with or takeover of Telecom Italia more difficult or discourage certain bidders from making an offer. Please see Item 7. Major Shareholders and Related-Party Transactions 7.1 Major Shareholders 7.1.3 Continuing Relationship with the Italian Treasury for more information.

System failures could result in reduced user traffic and reduced revenue and could harm Telecom Italia's reputation.

Our technical infrastructure (including our network infrastructure for fixed-line and mobile telecommunication services) is vulnerable to damage or interruption from information and telecommunication technology failures, power loss, floods, windstorms, fires, terrorism, intentional wrongdoing, human error and similar events. Unanticipated problems at our facilities, system failures, hardware or software failures, computer viruses or hacker attacks could affect the quality of our services and cause service interruptions. Any of these occurrences could result in reduced user traffic and reduced revenue and could harm our reputation.

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Identification of significant deficiencies or material weaknesses as a result of our implementation of procedures designed to comply with Section 404 of the Sarbanes-Oxley Act of 2002 relating to evaluation of our internal control over financial reporting may have an adverse impact on our financial condition and results of operations and the trading price of our securities.

Commencing with our annual report on Form 20-F for the year ending December 31, 2006, we will include a report from our management relating to its evaluation of our internal control over financial reporting as required under Section 404 of the U.S. Sarbanes-Oxley Act of 2002. As a consequence of systems and procedures currently being reviewed and implemented to comply with these requirements, we may uncover circumstances that may be determined to be significant deficiencies or material weaknesses, or that may otherwise result in disclosable conditions. Although we intend to take prompt measures to remediate any such identified significant deficiencies or material weaknesses in our internal control structure, measures of this kind may involve significant effort and expense, and any disclosure of such significant deficiencies, material weaknesses or other disclosable conditions may result in a negative market reaction.

Table of Contents**Item 3. Key Information****Exchange Rates****3.2 EXCHANGE RATES**

We publish our consolidated financial statements in euros. References to **euro** and **Euro** are to the euro, the single unified currency that was introduced in Italy and 10 other member states of the EU on January 1, 1999. References to **lire**, **lira** and **Lit.** are to Italian lire, the former Italian non-decimal denomination of the euro, and references to **U.S. dollars**, **dollars**, **U.S.\$** or **\$** are to U.S. dollars, the currency of the United States of America. The exchange rate at which the lira was irrevocably fixed against the euro is Lit.1,936.27 = 1.00.

For convenience only (except where noted otherwise), certain euro figures have been translated into dollars at the rate (the **Euro/Dollar Exchange Rate**) of 1.00= U.S.\$1.1842, using the noon buying rate in The City of New York for cable transfers in foreign currencies as announced by the Federal Reserve Bank of New York for customs purposes (the **Noon Buying Rate**) on December 30, 2005.

These translations should not be construed as a representation that the euro amounts actually represent such dollar amounts or have been or could be converted into dollars at the rate indicated.

The Federal Reserve Bank of New York no longer quotes a Noon Buying Rate for the legacy currencies of any of the Member States.

For the purpose of this Annual Report, **billion** means a thousand million.

The following table sets forth for the years 2001 to 2005 and for the beginning of 2006 certain information regarding the Noon Buying Rate for Dollars expressed in U.S.\$ per 1.00.

Calendar Period	High	Low	Average(1)	At Period end
2001	0.9535	0.8425	0.8909	0.8901
2002	1.0485	0.8594	0.9495	1.0485
2003	1.2597	1.0361	1.1411	1.2597
2004	1.3625	1.1801	1.2438	1.3538
2005	1.3476	1.1667	1.2448	1.1842
2006 (through May 10, 2006)	1.2799	1.1860	1.2145	1.2799
Monthly Amounts				
December 2005	1.2041	1.1699	1.1861	1.1842
January 2006	1.2287	1.1980	1.2126	1.2158
February 2006	1.2100	1.1860	1.1940	1.1925
March 2006	1.2197	1.1886	1.2028	1.2139

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April 2006	1.2624	1.2091	1.2273	1.2624
May 2006 (through May 10, 2006)	1.2799	1.2607	1.2697	1.2799

(1) Average of the rates for each month in the relevant period except for May, 2006 for which the dates used are through May 10, 2006.

The Ordinary Shares and Savings Shares of Old Telecom Italia and the Ordinary Shares of Olivetti have traded on *Mercato Telematico Azionario* (**Telematico**), managed by Borsa Italiana S.p.A. (**Borsa Italiana**) in euro since January 4, 1999. Fluctuations in the exchange rate between the euro and the U.S. dollar will affect the U.S. dollar equivalent of the euro price of the Ordinary Shares and the Savings Shares and the price of the Ordinary Share American Depositary Shares (**Ordinary Share ADSs**) and the Savings Share American Depositary Shares (**Savings Share ADSs**), on the New York Stock Exchange (**NYSE**). Cash dividends were paid by Old Telecom Italia and Olivetti in lire until 2001 (Olivetti paid no dividend in 2001) and in euro starting from 2002 (Olivetti paid no dividend in 2002). Exchange rate fluctuations will affect the U.S. dollar amounts received by owners of Ordinary Share ADSs and Savings Share ADSs upon conversion by the Depositary of cash dividends paid in euro on the underlying Ordinary Shares and Savings Shares. See Item 10. Additional Information 10.5 Description of American Depositary Receipts .

On completion of the Merger, Telecom Italia (formerly Olivetti) became a successor registrant to Old Telecom Italia under the Securities Exchange Act of 1934, as amended (the 1934 Act) and, therefore, became subject to and continues to file periodic reports under the 1934 Act required for a foreign private issuer. Telecom Italia (formerly Olivetti) obtained a listing of the Ordinary Shares and Savings Shares issued at completion of the Merger, on the NYSE where such Ordinary Shares and Savings Shares trade in the form of ADSs.

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Item 3. Key Information

Selected Financial And Statistical Information

3.3 SELECTED FINANCIAL AND STATISTICAL INFORMATION

The summary selected financial data set forth below are consolidated financial data of the Telecom Italia Group as of and for each of the years ended December 31, 2004 and 2005, which have been extracted or derived from the Consolidated Financial Statements of the Telecom Italia Group prepared in accordance with IFRS and which have been audited by the independent auditor Reconta Ernst & Young S.p.A..

Unless otherwise indicated, amounts presented in this section are prepared in accordance with IFRS.

Until December 31, 2004, Telecom Italia prepared its consolidated financial statements and other interim financial information (including quarterly and semi-annual data) in accordance with Italian GAAP. Pursuant to SEC Release 33-8567, *First-Time Application of International Financial Reporting Standards*, Telecom Italia is only required to include consolidated financial statements for 2004 and 2005 (earlier periods are not required to be included).

The accompanying IFRS financial data has been prepared in accordance with IFRS effective at December 31, 2005. For the purposes of the Consolidated Financial Statements included elsewhere in this Annual Report there are no differences between IFRS issued by IASB and IFRS adopted by the EU.

For a more complete description of the adoption of IFRS please see Item 5. Operating and Financial Review and Prospects 5.4 Adoption of International Financial Reporting Standards as well as Note 42 Transition to International Financial Reporting Standards (IFRS) of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report.

The selected financial data below should be read in conjunction with the Consolidated Financial Statements and notes thereto included elsewhere in this Annual Report.

Table of Contents**Item 3. Key Information****Selected Financial And Statistical Information**

	Year ended December 31,		
	2004	2005	2005
	(millions of Euro, except percentages and per share amounts)		(millions of U.S. dollars, except percentages and per share amounts)(1)
Statement of Operations Data in accordance with IFRS:			
Revenues	28,292	29,919	35,430
Operating income	7,603	7,499	8,880
Net income from continuing operations	2,952	3,140	3,718
Net income (loss) from discontinued operations/assets held for sale	(118)	550	651
Net income	2,834	3,690	4,369
<i>Of which:</i>			
• <i>Net income attributable to the Group</i>	<i>1,815</i>	<i>3,216</i>	<i>3,808</i>
• <i>Net income attributable to Minority interests</i>	<i>1,019</i>	<i>474</i>	<i>561</i>
Financial Ratios in accordance with IFRS:			
Revenues/Employees (average number in Group, excluding employees relating to the consolidated companies considered as discontinued operations/assets held for sale and including temporary employees) (thousands)(2)	355.4	374.6	443.6
Operating income/Revenues (ROS)(%)	26.9	25.1	25.1
Basic and Diluted earnings per Share(3):			
Ordinary Share	0.11	0.17	0.20
Savings Share	0.12	0.18	0.21
<i>Of which:</i>			
<i>From continuing operations:</i>			
• <i>Ordinary Share</i>	<i>0.12</i>	<i>0.14</i>	<i>0.17</i>
• <i>Savings Share</i>	<i>0.13</i>	<i>0.15</i>	<i>0.18</i>
<i>From discontinued operations/assets held for sale:</i>			
• <i>Ordinary Share</i>	<i>(0.01)</i>	<i>0.03</i>	<i>0.03</i>
• <i>Savings Share</i>	<i>(0.01)</i>	<i>0.03</i>	<i>0.03</i>
Dividends:			

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• per Ordinary Share	0.1093	0.1400(4)	0.1658
• per Savings Share	0.1203	0.1510(4)	0.1788

Table of Contents**Item 3. Key Information****Selected Financial And Statistical Information**

	As of December 31,		
	2004	2005	2005
	(millions of Euro, except percentages and employees)		(millions of U.S. dollars, except percentages and employees)(1)
Balance Sheet Data in accordance with IFRS:			
Total assets	81,834	96,010	113,695
Shareholders equity:			
Shareholders equity attributable to the Group	16,248	25,662	30,389
Shareholders equity attributable to Minority interests	4,550	1,323	1,567
Total shareholders equity	20,798	26,985	31,956
Total liabilities	61,036	69,025	81,739
Total shareholders equity and liabilities	81,834	96,010	113,695
Share capital(5)	8,809	10,599	12,551
Financial Ratios in accordance with IFRS:			
• Net financial debt/Net invested capital (debt ratio)(%)(6)	61.2	59.6	59.6
• Employees (number in Group at year-end, excluding employees relating to the consolidated companies considered as discontinued operations/assets held for sale and including temporary employees)	82,620	85,484	

Table of Contents**Item 3. Key Information****Selected Financial And Statistical Information**

	Year ended December 31,					
	2001	2002	2003	2004	2005	2005
	(millions of Euro, except per share amounts)					(millions of U.S. dollars, except per share amounts)(1)
Statement of Operations Data in accordance with U.S. GAAP:						
• Revenues	27,025	26,769	27,290	28,292	29,921	35,432
• Operating income	3,159	6,724	7,626	6,822	5,874	6,956
• Net income (loss) before minority interests, discontinued operations / assets held for sale and cumulative effect of accounting changes	(3,001)	6,272	3,064	2,899	1,962	2,323
• Minority interests	18	(3,016)	(1,523)	(1,167)	(479)	(567)
• Net income (loss) from discontinued operations / assets held for sale	(1,043)	(1,300)	319	(191)	409	484
• Cumulative effect of accounting changes, net of taxes	20	0	(19)	0	47	56
• Net income (loss)(7)	(4,006)	1,956	1,841	1,541	1,939	2,296
Basic and Diluted earnings per Ordinary Share(8):						
• Net income (loss) after minority interests per Ordinary Share from continuing operations	(0.87)	0.80	0.17	0.10	0.08	0.10
• Net income (loss) after minority interests per Ordinary Share from discontinued operations/assets held for sale	(0.31)	(0.32)	0.04	(0.01)	0.02	0.02
• Net income (loss) after minority interests per Ordinary Share from cumulative effect of accounting changes	0.01	0.00	(0.01)	0.00	0.00	0.00
• Net income (loss) per Ordinary Share	(1.17)	0.48	0.20	0.09	0.10	0.12
Basic and Diluted earnings per Savings Share(8):						
• Net income (loss) after minority interests per Savings Share from continuing operations			0.18	0.11	0.09	0.11
• Net income (loss) after minority interests per Savings Share from discontinued operations/assets held for sale			0.04	(0.01)	0.02	0.02
• Net income (loss) after minority interests per Savings Share from cumulative effect of accounting changes			(0.01)	0.00	0.00	0.00
• Net income (loss) per Savings Share			0.21	0.10	0.11	0.13

Table of Contents**Item 3. Key Information****Selected Financial And Statistical Information**

	As of December 31,					
	2001	2002	2003	2004	2005	2005
	(millions of Euro)					(millions of U.S. dollars)(1)
Balance Sheet Data in accordance with U.S. GAAP:						
Total assets	104,212	93,367	108,335	106,919	123,304	146,017
Shareholders equity(9)	13,611	15,221	35,067	34,827	44,631	52,852
Total liabilities(10)	90,601	78,146	73,268	72,092	78,673	93,165
Total shareholders equity and liabilities	104,212	93,367	108,335	106,919	123,304	146,017
Share capital(5)	8,570	8,630	8,798	8,809	10,599	12,551

	As of December 31,					
	2001	2002	2003	2004	2005	
Statistical Data:						
Wireline:						
Subscriber fixed-lines in Italy (thousands)(11)		27,353	27,142	26,596	25,957	25,049
<i>of which: ISDN equivalent lines in Italy (thousands)(11)</i>		5,403	5,756	6,027	5,805	5,459
Broadband Access(12):						
• in Italy (thousands)		390	850	2,040	4,010	5,707
• in Europe (thousands)				160	420	1,313
Voice Offers in Italy (thousands)(13)	4,094	5,224	5,547	5,883	6,392	
Page views Virgilio (millions)	3,945	5,267	6,612	7,902	9,842	
Unique users Virgilio (monthly average number) (millions)	6.5	9.5	12.0	13.9	15.7	
Network infrastructure in Italy:						
• access network in copper (millions of km pair)	104.3	104.3	105.2	105.2	105.2	
• access network and transport in fiber optics (millions of km of fiber optics)	3.2	3.6	3.6	3.7	3.7	
Network infrastructure abroad:						
• European backbone (km of fiber optics)	36,600	36,600	39,500	39,500	51,000	
Mobile:						
Mobile lines in Italy at period-end (thousands)(14)	23,946	25,302	26,076	26,259	28,576	
Foreign mobile lines at period-end (thousands)(15)	4,558	5,335	8,304	13,588	20,171	
Total mobile lines at period-end (Italy + foreign in thousands)(15)	28,504	30,637	34,380	39,847	48,747	
GSM coverage in Italy (% of population)	99.7	99.8	99.8	99.8	99.8	
Media:						
La7 average audience share for the year (%)	2.0	1.8	2.2	2.4	2.7	
La7 average audience share for the month of December (%)	1.8	2.1	2.2	2.6	3.1	

(1) For the convenience of the reader, Euro amounts for 2005 have been converted into U.S. dollars using the Euro/Dollar Exchange Rate in effect on December 30, 2005 of 1.00 = U.S.\$1.1842.

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- (2) The average number of employees in the Group (excluding employees relating to the consolidated companies considered as discontinued operations / assets held for sale and including temporary employees) was 79,602 and 79,869 in 2004 and 2005, respectively.
- (3) In accordance with IAS 33 Earnings per share, basic earnings per Ordinary Share is calculated by dividing the Group's net income available to shareholders by the weighted average number of shares outstanding during the year, excluding treasury shares.

Since Telecom Italia, has both Ordinary and Savings Shares outstanding, the calculations also take into account the requirement that holders of Savings Shares are entitled to an additional dividend equal to 2% of the par value of shares above dividends paid on the Ordinary Shares.

For the purpose of these calculations, the weighted average number of:

- Ordinary Shares was 10,208,327,613 for the year ended December 31, 2004 and 12,283,195,845 for the year ended December 31, 2005; and
- Savings Shares was 5,795,921,069 for the year ended December 31, 2004 and 5,930,204,164 for the year ended December 31, 2005.

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Item 3. Key Information

Selected Financial And Statistical Information

For diluted earnings per share the weighted average number of shares outstanding is adjusted assuming conversion of all dilutive potential shares. Potential shares are those securities that, if converted into shares, would increase the total number of shares outstanding and reduce the earnings attributable to each share. Potential shares include options, warrants and convertible securities. The Group's net income is also adjusted to reflect the impact of the conversion of potential shares net of the related tax effects.

- (4) Telecom Italia's dividend coupons for the year ended December 31, 2005, were clipped on April 24, 2006 and were payable from April 27, 2006.
- (5) Share capital represents share capital issued net of the par value of treasury shares.
- (6) Net Financial Debt is a Non-GAAP Financial Measure as defined in Item 10 of Regulation S-K under the 1934 Act. For further details please see Item 5. Operating and Financial Review and Prospects 5.5 Results of Operations for the Two Years Ended December 31, 2005 5.5.2 Non-GAAP Financial Measures .
- (7) Excludes Minority interests.
- (8) In accordance with U.S. GAAP, the Net income (loss) per Ordinary Share has been calculated using the two class method, since the Company has both Ordinary Shares and Savings Shares outstanding. Under this method, set forth in Statement of Financial Accounting Standards No. 128, *Earnings per Share* , Basic earnings per share is computed by dividing income available to shareholders by the weighted average number of shares outstanding. For the purpose of these calculations, the weighted average number of Ordinary Shares was 3,424,694,178 for the year ended December 31, 2001 and 4,054,375,543 for the year ended December 31, 2002. The weighted average number of Ordinary Shares and Savings Shares was 6,620,513,494 and 2,414,967,112 for the year ended December 31, 2003, 10,208,327,613 and 5,795,921,069 for the year ended December 31, 2004 and 12,283,195,845 and 5,930,204,164 for the year ended December 31, 2005. The calculations take into account the requirement that holders of Savings Shares are entitled to an additional dividend equal to 2% of the par value of Savings Shares in addition to dividends paid on the ordinary shares. The calculations also take into account that in 2001 and 2002 (after the redenomination of the share capital into Euro following the resolution taken by the Extraordinary Shareholders Meeting held on July 4, 2000) the par value of Ordinary Shares was 1 per share, and that in 2003, after the Merger, the par value of Ordinary Shares and Savings Shares was reduced to 0.55 per share.

For diluted earnings per share the weighted average number of shares outstanding is increased to include any potential common shares and is adjusted for any changes to income that would result from the assumed conversion of those potential common shares.

- (9) Shareholders' equity under U.S. GAAP is calculated after elimination of minority interests.
- (10) Includes minority interests.
- (11) Data exclude internal lines.
- (12) Number of contracts.
- (13) Number of contracts; data include Teleconomy, Hellò and other Business voice offers.
- (14) Includes TACS, GSM and UMTS services, including Prepaid Customers and excludes silent lines.

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(15) Comprises foreign lines of the subsidiaries included in the Mobile Business Unit and excludes those of the mobile subsidiaries considered as discontinued operations/assets held for sale.

Table of Contents**Item 3. Key Information****Dividends****3.4 DIVIDENDS**

The determination of our future dividend policy, and the amounts thereof, will depend upon a number of factors, including but not limited to our earnings, financial condition and cash requirements, prospects and such other factors as may be deemed relevant at the time. Subject to the foregoing, we plan to maintain our dividend over the period 2006-2008 at a level comparable to that paid out for 2005.

Dividends declared by Old Telecom Italia. The following table sets forth the dividends per Ordinary Share and per Savings Share declared by Old Telecom Italia with respect to the two fiscal years ended December 31, 2001 and 2002, respectively, and the aggregate dividend paid in such years. Actual dividends paid are rounded to the nearest whole cent.

Year ended December 31,	Dividends on Ordinary Shares			Dividends on Savings Shares		
	Euro per Share	U.S. dollars per Share(1)	Millions of Euro	Euro per Share	U.S. dollars per Share(1)	Millions of Euro
2001	0.3125(2)	0.28	1,644.19	0.3237(2)	0.29	662.33
2002	0.1357(3)	0.13	713.47	0.1357(3)	0.13	273.11

(1) Euro amounts have been translated into U.S. dollars using the Noon Buying Rate in effect on the respective payment dates.

(2) Approved at the Annual Meeting of Shareholders of Old Telecom Italia held on May 7, 2002. Old Telecom Italia's dividend coupons for the year ended December 31, 2001 were payable from May 23, 2002. Dividends for the year ended December 31, 2001 were paid also utilizing reserves.

(3) In order to ensure shareholders dividends commensurate with those paid out for 2001, in December 2002, reserves were distributed and paid corresponding to a dividend of 0.1357 per Old Telecom Italia Ordinary Share and a dividend of 0.1357 per Old Telecom Italia Savings Share. Furthermore, the shareholders' Meeting of Old Telecom Italia held on May 24, 2003 approved an additional dividend of 0.1768 per Old Telecom Italia Ordinary Share and 0.1878 per Old Telecom Italia Savings Share, payable from income and capital reserves.

Dividends declared by Telecom Italia (formerly Olivetti). The following table sets forth the dividends per Ordinary Share, per Savings Share and per Preferred Share declared by Telecom Italia (Olivetti prior to the Merger) with respect to each of the last five fiscal years and the aggregate dividend paid in such years. Actual dividends paid are rounded to the nearest whole cent.

Year ended December 31,	Dividends on Ordinary Shares			Dividends on Savings Shares		
	Euro per Share	U.S. dollars per Share(1)	Millions of Euro	Euro per Share	U.S. dollars per Share(1)	Millions of Euro
2001						

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2002						
2003	0.1041	0.1278	1,072.95	0.1151	0.1413	667.11
2004	0.1093	0.1431	1,225.99	0.1203	0.1575	697.25
2005(2)	0.1400	0.1753	1,873.12	0.1510	0.1891	909.94

(1) Euro amounts have been translated into U.S. dollars using the Noon Buying Rate in effect on the respective payment dates.

(2) Approved at the Annual Shareholders Meeting held on April 13, 2006. Pursuant to Italian Stock Exchange rules, dividends on the Ordinary Shares and the Savings Shares are payable from the fourth trading day after the third Friday of each month, and in any case, at least four business days after the Annual Meeting of Shareholders approving the dividends. Telecom Italia's dividend coupons for the year ended December 31, 2005 were clipped on April 24, 2006, and were payable from April 27, 2006.

Payment of annual dividends is subject to approval by the holders of Ordinary Shares at the annual general shareholders meeting, which must be convened within 120 days after the end of the financial year to which it relates or, in case specific reasons arise, within 180 days, the reasons for the delay to be described in the annual report. In addition, Article 21 of the Company's Bylaws gives the Board of Directors the power to approve the distribution of interim dividends. Pursuant to Italian law, the distribution may be approved after the final approval of the preceding year's financial statements, and the interim dividends may not exceed the lower of (i) the difference between profits from the preceding fiscal year and amounts required to be attributed to legal and statutory reserves and (ii) available reserves. Once paid in compliance with applicable laws, shareholders cannot be required to repay interim dividends to the Company if the shareholders collected such dividends in good faith. Dividends not collected within five years from the date they become payable will be forfeited in favor of the Company. If profits are not fully distributed, additional reserves are created.

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Item 3. Key Information

Dividends

According to the Italian Civil Code, before dividends may be paid with respect to any year, an amount equal to 5% of the net income of the Company for such year must be set aside to the legal reserve until the legal reserve, including amounts set aside during prior years, is at least equal to one-fifth of the par value of the Company's issued share capital. This legal reserve is not available for payment of dividends. Such restriction on the payment of dividends applies, on a non-consolidated basis, to each Italian subsidiary of the Telecom Italia Group. The Company may also pay dividends out of available retained earnings from prior years or other reserves.

Dividends in respect of Ordinary Shares and Savings Shares held with Monte Titoli S.p.A (Monte Titoli) are automatically credited to the accounts of the beneficial owners with the relevant participant of Monte Titoli, without the need for presentation by such beneficial owners of any documentation. See Item 10. Additional Information 10.4 Description of Capital Stock .

Arrangements between Euroclear or Clearstream and Monte Titoli permit the shareholders to collect the dividends through Euroclear or Clearstream. Holders of American Depositary Receipts (ADRs) are entitled to receive payments in respect of dividends on the underlying Ordinary Shares and Savings Shares, as the case may be, in accordance with the relevant Deposit Agreement.

Dividends payable on the Company's Ordinary Shares and Savings Shares may be subject to deduction of Italian withholding tax. See Item 10. Additional Information 10.6 Taxation . Italian regulations do not contain any specific restrictions on the payment of dividends to non-residents of Italy. See Item 10. Additional Information 10.2 Exchange Controls and Other Limitations Affecting Security Holders .

Pursuant to Italian law, in connection with the payment of dividends, participants of Monte Titoli are required to supply to the Italian tax authorities certain information concerning the identity of non-resident shareholders holding Ordinary Shares or Savings Shares. Shareholders are required to provide their Italian tax identification number, if any, or alternatively, in the case of legal entities, their name, country of establishment and address, or in the case of individuals, their name, address and place and date of birth, or in the case of partnerships, the information required for legal entities and the information required for individuals with respect to one of their representatives.

In the case of Ordinary Share ADSs and Savings Share ADSs owned by non-residents of Italy, Telecom Italia understands that the provision of information concerning the Depository, in its capacity as holder of record of the Ordinary Shares and Savings Shares, as the case may be, will satisfy these requirements. The Depository, in accordance with Telecom Italia, will be required to provide information to beneficial owners of Ordinary Share ADSs and Savings Share ADSs, that are considered U.S. residents for purposes of applicable law, to the extent such owners wish to benefit from reduced withholding tax rates on dividends under an income tax convention, and claims for such benefits therefore must be accompanied by the required information. See Item 10. Additional Information 10.6 Taxation .

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Item 4. Information On The Telecom Italia Group

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Item 4. INFORMATION ON THE TELECOM ITALIA GROUP

4.1 BUSINESS

4.1.1 BACKGROUND

The legal and commercial name of the company is Telecom Italia S.p.A.. The company is incorporated as a joint stock company under the laws of Italy. The duration of the company extends until December 31, 2100. The registered office and principal executive offices of Telecom Italia are at Piazza degli Affari 2, 20123 Milan, Italy. The telephone number is +39-02-85951.

On July 18, 1997, Old Telecom Italia's predecessor company was merged with and into Società Finanziaria Telefonica per Azioni (**STET**), its parent holding company, with STET as the surviving corporation. As of the effective date of the merger, STET changed its name to Telecom Italia S.p.A. . In November 1997, the Ministry of the Treasury of the Republic of Italy completed the privatization of Telecom Italia, selling substantially all of its stake in the Old Telecom Italia Group through a global offering and a private sale to a stable group of shareholders.

On May 21, 1999, Olivetti, through a tender offer, obtained control of the Old Telecom Italia Group when approximately 52.12% of Old Telecom Italia Ordinary Shares were tendered to Olivetti. Through a series of transactions which started in July 2001, Olimpia S.p.A. (**Olimpia**) acquired a 28.7% stake in Olivetti which resulted in the replacement of the then boards of directors of Olivetti and Old Telecom Italia. Please see Item 7. Major Shareholders and Related-Party Transactions 7.1 Major Shareholders 7.1.1 The Olimpia Shareholders Agreements .

On December 9, 2002, the Ministry of the Treasury sold its remaining stake in Old Telecom Italia Ordinary and Savings share capital.

On August 4, 2003, Old Telecom Italia merged with and into Olivetti (the Merger) with Olivetti as the surviving company changing its name to Telecom Italia S.p.A. . Following the Merger, the proportionate ownership of Telecom Italia's share capital by shareholders unaffiliated with Olimpia or Pirelli & C. S.p.A. (**Pirelli**), Olimpia's largest shareholder, increased substantially to approximately 88.43% of the outstanding Ordinary Shares. Following the Merger, Olimpia acquired additional shares through market purchases and, prior to the TIM Acquisition (see 4.1.3 Significant Developments during 2005 TIM Acquisition), Olimpia held approximately 17% of Telecom Italia's Ordinary Shares, making it the largest shareholder of Telecom Italia.

On December 22, 2004, Olimpia's shareholders approved a capital increase in the amount of 2 billion to finance the acquisition of additional Ordinary Shares. As a result, on March 11, 2005, Olimpia announced that it had acquired 189,988,330 additional Ordinary Shares and increased its total holdings to 2,207,345,359 Ordinary Shares, equal to approximately 20.4% of the Ordinary Share capital of Telecom Italia. In addition, as of March 14, 2005, the conversion of over 424 million Telecom Italia convertible bonds became effective, which further increased Olimpia's aggregate shareholding to 2,407,345,359 Ordinary Shares, representing

approximately 21.4% of the outstanding Ordinary Shares.

Following the issuance of shares of Telecom Italia in exchange for outstanding shares of TIM held by third parties, as a result of the merger of TIM into Telecom Italia through which the TIM Acquisition was effected, Olimpia's stake was diluted to approximately 18% (corresponding to 2,407,345,359 Ordinary Shares).

By letter dated February 6, 2006, Pirelli, Edizione Holding S.p.A., Edizione Finance International S.A., UniCredito Italiano S.p.A., Banca Intesa S.p.A. and Olimpia notified Hopa of their withdrawal from the agreement between Pirelli, Edizione Holding S.p.A., Edizione Finance International S.A., UniCredito Italiano S.p.A., Banca Intesa S.p.A., Hopa and Olimpia, entered into on February 21, 2003 and subsequently modified on January 23, 2004 and January 28, 2005; with letters dated respectively March 27 and March 28, 2006, Banca Intesa S.p.A. and UniCredito Italiano S.p.A. notified Pirelli of their withdrawal from the agreement between Pirelli, UniCredito Italiano S.p.A. and Banca Intesa S.p.A., entered into on September 14, 2001 and subsequently modified on September 26, 2001, October 24, 2001 and December 16, 2003. With the aforementioned letters Banca Intesa S.p.A. and UniCredito Italiano S.p.A. exercised their rights to sell their entire holdings in Olimpia to Pirelli. Please see Item 7. Major Shareholders and Related-Party Transactions 7.1 Major Shareholders 7.1.1 The Olimpia Shareholders Agreements .

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In January 2004, Hopa announced it had acquired a shareholding then equal to 3.367% of Telecom Italia's Ordinary Shares, held, in part, directly (13,203,484 Ordinary Shares) and in the remaining part through Holinvest S.p.A. (Holinvest), a company owned by Hopa (80.001%) and Olimpia (19.999%). On April 15, 2004, Holinvest exchanged with JPMorgan Ltd. 95,606,875 of Telecom Italia's convertible bonds for 46,343,969 Ordinary Shares.

From June 9, 2005 to March 22, 2006 Pirelli Finance S.A. (a Luxemburg wholly owned subsidiary of Pirelli) acquired an aggregate amount of 134,957,885 Ordinary Shares, through market transactions and exercise of call options granted to Pirelli Finance S.A. by JPMorgan Chase Bank N.A. and HSBC Bank Plc.

As of April 13, 2006 (the date of Telecom Italia's annual shareholders' meeting), Hopa, directly and through Holinvest, owned 451,568,211 Ordinary Shares (equal to 3.38% of the outstanding Ordinary Shares), while Pirelli directly and through Pirelli Finance S.A. owned 182,113,185 Ordinary Shares (equal to 1.36% of the outstanding Ordinary Shares).

In addition,

- on November 14, 2001, Pirelli (now Pirelli Finance S.A.) entered into a swap transaction with Credit Agricole Lazard Financial Products Bank (now convertible into Calyon S.A.) with respect to 200,000,000 Olivetti convertible bonds (now 94,310,600 Ordinary Shares). The swap transaction may be settled, at Pirelli's option, either in cash or by physical delivery of Ordinary Shares on November 23, 2006, upon payment by Pirelli of an aggregate amount of 200,000,000;
- on February 8, 2002, Pirelli Finance S.A. entered into an equity swap transaction with JPMorgan Chase Bank, pursuant to which JPMorgan Chase Bank agreed to pay to Pirelli Finance S.A. an amount equal to any increase, and Pirelli Finance S.A. agreed to pay to JPMorgan Chase Bank an amount equal to any decrease, above or below a reference price of 1.4213 (now 3.01) per security in the average official market price of 100,000,000 Olivetti shares (now corresponding to 44,797,535 Ordinary Shares and 5,000,000 Telecom Italia Convertible Bonds) over the period of 10 trading days commencing on December 1, 2006. Pirelli Finance S.A. has the right to settle the swap transaction by physical delivery, in which case Pirelli Finance S.A. has the right to receive the aforementioned securities upon payment of 142,130,000;
- on December 28, 2005 Pirelli Finance S.A. purchased from Mediobanca Banca di Credito Finanziario S.p.A. a call option, in consideration for selling a corresponding put option, each with respect to 40,000,000 Ordinary Shares. The call option may be exercised by Pirelli Finance S.A. in whole on June 16, 2006 at 2.5765 per share and the put option may be exercised by Mediobanca Banca di Credito Finanziario S.p.A. in whole on June 16, 2006 at 2.2590 per share. Pirelli Finance S.A. may require that the relevant option be settled in cash;
- on December 30, 2005 Pirelli Finance S.A. purchased from HSBC Bank Plc. a call option, in consideration for selling a corresponding put option, each with respect to 40,000,000 Ordinary Shares. The call option may be exercised by Pirelli Finance S.A. in whole on June 16, 2006 at 2.5832 per share and the put option may be exercised by HSBC Bank Plc. in whole on June 16, 2006 at 2.2205 per share. Pirelli Finance S.A. may require that the relevant option be settled in cash.

According to publicly available filings with Consob, as of April 14, 2006, the shareholders of Pirelli with a 5% shareholding or greater in Pirelli's voting capital were Camfin CAM Finanziaria S.p.A. (25.387%) and Assicurazioni Generali S.p.A. (5.251%). On the

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same date shareholders of Camfin CAM Finanziaria S.p.A. with a 5% shareholding or greater in the voting capital of the company included Mr. Marco Tronchetti Provera (through Gruppo Partecipazioni Industriali S.p.A. (50.180%)) and Mr. Carlo Acutis (through Vittoria Assicurazioni S.p.A. (4.648%) and Yura International Holding B.V. (4.649%)).

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The following chart illustrates Telecom Italia's current ownership structure.

(1): Shareholders of Pirelli & C. S.p.A. with a 5% stake or greater in the voting capital of the company include: Camfin CAM Finanziaria S.p.A. (25.387%) and Assicurazioni Generali S.p.A. (5.251%).

* By letter dated March 28, 2006, UniCredito Italiano S.p.A. notified Pirelli (i) of its withdrawal from the agreement between Pirelli, UniCredito Italiano S.p.A. and Banca Intesa S.p.A., entered into on September 14, 2001 and subsequently modified on September 26, 2001, October 24, 2001 and December 16, 2003. With the same letter UniCredito Italiano S.p.A. exercised its right to sell its entire holding in Olimpia to Pirelli for a consideration of approximately 585 million, in line with the carrying value.

** By letter dated March 27 2006, Banca Intesa S.p.A. notified Pirelli of its withdrawal from the agreement between Pirelli, UniCredito Italiano S.p.A. and Banca Intesa S.p.A., entered into on September 14, 2001 and subsequently modified on September 26, 2001, October 24, 2001 and December 16, 2003. With the same letter Banca Intesa S.p.A. exercised its right to sell its entire holding in Olimpia to Pirelli for a consideration of approximately 585 million, in line with the carrying value.

*** By letter dated February 6, 2006, Pirelli, Edizione Holding S.p.A., Edizione Finance International S.A., UniCredito Italiano S.p.A., Banca Intesa S.p.A. and Olimpia notified Hopa of their withdrawal from the agreement between Pirelli, Edizione Holding S.p.A., Edizione Finance International S.A., UniCredito Italiano S.p.A., Banca Intesa S.p.A., Hopa and Olimpia, entered into on February 21, 2003 and subsequently modified on January 23, 2004 and January 28, 2005.

For the glossary of selected telecommunications terms used in the following description of the Telecom Italia Group's business and elsewhere in this Report see 4.4 Glossary of Selected Telecommunications Terms .

4.1.2 GENERAL

Olivetti S.p.A. (now Telecom Italia S.p.A.) was founded in 1908 at Ivrea, near Turin, as a typewriter manufacturer. The company changed its focus gradually, turning first into a computer manufacturer and eventually into a telecommunications company.

In May 1999, Olivetti S.p.A. and its subsidiary, Tecnost S.p.A., successfully completed a cash and stock tender offer for all of old Telecom Italia S.p.A.'s Ordinary Shares.

In March 2003, plans for the merger of Telecom Italia S.p.A. into Olivetti S.p.A. were announced. The merger plan was approved by the shareholders of Telecom Italia S.p.A. and Olivetti S.p.A. in meetings held on May 24 and 26, 2003, respectively. Following the merger, which took effect on August 4, 2003, Olivetti S.p.A. adopted Telecom Italia's corporate purpose and name.

The Telecom Italia Group is a world leader in the information and communication technology sector. As leaders in wireline and mobile communications, our companies provide integrated and innovative services in Italy and certain countries outside of Italy.

Moreover, the Telecom Italia Group is also active in the media sector and it supplies office products and solutions, commercial systems and IT for gaming and lotteries.

In our domestic Italian market, we are both a technological and market leader in the fastest-growing market segments (mobile, broadband and data transmission). Our international operations are concentrated mainly in Latin America, Europe and the Mediterranean basin.

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In particular, at December 31, 2005, the Telecom Italia Group was one of the world's largest wireline operators, with approximately 25.0 million subscriber fixed-lines installed (including ISDN equivalent lines). In addition, the Telecom Italia Group was the leading mobile operator in Italy, with 28.6 million lines at December 31, 2005; and as of the same date Telecom Italia Group had 20.1 million foreign mobile lines, resulting in a total of 48.7 million mobile lines.

As a result of the merger with Tim Italia, Telecom Italia S.p.A. is one of the three mobile operators licensed to provide services using GSM 900 technology in Italy and one of the three operators licensed to provide services using GSM 1800 (formerly DCS 1800) technology in Italy. It is also one of four operators holding a UMTS license and providing third-generation telephony services in Italy.

4.1.3 SIGNIFICANT DEVELOPMENTS DURING 2005

One Company Model

On October 5, 2005 the Board of Directors of Telecom Italia adopted a new business model, based on the integration of responsibilities for the development and management of the fixed and mobile telecommunication businesses and Internet services business, all of which were consolidated into a single organizational unit named Operations (Operations).

The adoption of the One Company Model was the outcome of both the TIM Acquisition (see below) and the restructuring of the Telecom Italia Group Internet activities (see below) which resulted in Operations replacing the separate business units of Wireline, Mobile and Media (with Telecom Italia Media focusing on the media industry only).

The overall process, dating from December 2004 (original plan for the integration of Telecom Italia and TIM), developed through 2005 (with the merger of TIM into Telecom Italia, the acquisition by Telecom Italia of the Internet activities previously operated by Telecom Italia Media and adoption of the One Company Model), and finally led in 2006 to the merger of Tim Italia with and into Telecom Italia.

The adoption of the One Company Model is our strategic response to changes in the demand for telecommunications services, increased competitive pressure and technological innovations, which are progressively erasing the traditional distinctions between fixed and mobile business areas. We consider that our ability to offer wireline, mobile and Internet services, as the demand for these services converges, provides us with a longer term competitive advantage which, if exploited, will be the means of achieving our targets of growth and profitability, as well as offering opportunities to rationalize costs and investments which are necessary in order to develop and introduce new technologies, manage innovation, provide value-added services and increase usage of our networks.

TIM Acquisition

On December 7, 2004, the Boards of Directors of Telecom Italia and TIM set out a plan for the integration of the two companies. Such plan was aimed at streamlining Telecom Italia Group's ownership structure and optimizing the financial and capital structure of the Telecom Italia Group resulting from the merger, against a backdrop of rapid technological development focused on promoting a significant increase in business efficiencies.

The integration plan of TIM into Telecom Italia was realized through:

- a partial voluntary cash tender offer (launched on January 3, 2005, and completed on January 21, 2005) by Telecom Italia for a certain number of TIM ordinary shares, equivalent to two thirds of the ordinary share free float, and for all TIM savings shares (the Cash Tender Offer) at a price of 5.60 per each TIM ordinary and savings share.

As a result of this, Telecom Italia acquired 2,456,501,605 TIM ordinary shares and 8,463,127 TIM savings shares for a total consideration of 13,804 million; the transfer to Telecom Italia of ownership of shares tendered and accepted took place on January 28, 2005.

In order to pay the consideration connected to the Cash Tender Offer, Telecom Italia used 2,504 million of its own funds and 11,300 million was drawn from the line of credit made available on

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December 8, 2004 by a pool of Italian and international banks for a maximum aggregate amount of 12,000 million, divided into three tranches (the first equal to 3,000 million; the second equal to 6,000 million; and the third equal to 3,000 million); the residual amount on the first tranche of the line of credit equal to 700 million, was cancelled. On February 11, 2005 the outstanding borrowings were reduced to 9,000 million with the first tranche of the line of credit repaid in the amount of 2,300 million. In addition, Telecom Italia incurred 98 million of further costs directly related to the Cash Tender Offer for the TIM shares;

- on February 3, 2005 and February 11, 2005, respectively, Telecom Italia acquired 21 million TIM savings shares for a consideration of 117 million, and 42 million TIM ordinary shares for a consideration of 234 million, as a result of the exercise of an option agreement entered into in December 2004. In addition, following the completion of the Cash Tender Offer, Telecom Italia purchased 5,063,893 (in accordance with IFRS, this transaction was recorded in the 2004 consolidated financial statements) additional TIM savings shares through market transactions for a consideration of 28 million;
- on February 24, 2005, TIM proceeded to spin off the corporate operations relating to the domestic mobile communications business to Tim Italia; the spin-off was effected by a Tim Italia capital increase against the conferral of the corporate operations with effect on March 1, 2005. The spin-off allowed Tim Italia to succeed TIM as the official licensee or holder of other authorizations to provide mobile communications services in Italy, as well as in all the user rights (even those temporarily assigned to TIM on the date of the contribution of the corporate operations), in the numbering and/or radio frequencies under concession, license, general authorization, and in the special authorizations ensuing from statements constituting declaration of the start of activities;
- on June 30, 2005, the merger of TIM with and into Telecom Italia took effect, at which time TIM's shares ceased trading on the Italian Stock Exchange. In particular, the exchange of TIM shares owned by third party shareholders into Telecom Italia Ordinary Shares and Savings Shares took place on June 30, 2005 at the following ratios:
 - 1.73 newly issued Telecom Italia Ordinary Shares, with a nominal value of 0.55 each, for every TIM ordinary share, with a nominal value of 0.06 each;
 - 2.36 newly issued Telecom Italia Savings Shares, with a nominal value of 0.55 each, for every TIM savings share, with a nominal value of 0.06 each.

As a result Telecom Italia issued 2,126,339,540 Ordinary Shares (net of 24,607,520 Ordinary Shares given in exchange to Telecom Italia Finance against 14,224,000 TIM shares it held) and 230,199,592 Savings Shares given in exchange to minority shareholders of TIM;

- as a result of the merger, on June 30, 2005 Telecom Italia obtained full control of TIM;
- on October 5, 2005 the Boards of Directors of Telecom Italia and Tim Italia, as a consequence of the adoption of the One Company Model, set out a plan for the merger of Tim Italia with and into Telecom Italia S.p.A..

The merger, which took effect on March 1, 2006, did not result in any changes to Telecom Italia's company bylaws, nor did it entail an increase in Telecom Italia's share capital, as Telecom Italia already held 100% of Tim Italia's shares which were subsequently cancelled without exchange, as a result of the merger.

For further details, see Note 4 Business Combinations, Acquisitions of Minority Interests and Transactions between Companies under Common Control of the Notes to the Consolidated Financial Statements.

Restructuring of the Telecom Italia Group Internet activities

In accordance with the decisions of the Boards of Directors of Telecom Italia and Telecom Italia Media of April 4, 2005, Telecom Italia and Telecom Italia Media entered into, on April 19, 2005, agreements for the restructuring of the Telecom Italia Group Internet Activities, with Telecom Italia Media to focus on the media industry. As a result:

- on June 1, 2005, Telecom Italia executed the contractual agreements with Telecom Italia Media for the purchase of the assets of Virgilio (through the companies Finanziaria Web and Matrix) and Tin.it, approved by the respective Boards of Directors on April 4, 2005.

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Under the deal, for a total consideration of 950 million, Telecom Italia purchased the following investments from Telecom Italia Media:

a 60% stake in Finanziaria Web and a 0.7% stake in Matrix at a total price of 70 million. At the conclusion of the deal, Telecom Italia, which, through ISM, already held a 40% stake in Finanziaria Web and a 33.3% stake in Matrix, owned (through ISM) 100% stakes in Finanziaria Web and Matrix and thus has full control over Virgilio. On December 31, 2005, Finanziaria Web and ISM were merged with and into Telecom Italia;

100% stake in Nuova Tin.it S.r.l., a newly-formed company to which Telecom Italia Media contributed the Tin.it business segment. The sale price was 880 million.

The aforementioned transaction also involved:

the buy-back, approved by the Telecom Italia Media Shareholders Meeting held on May 24, 2005, of Telecom Italia Media ordinary and savings shares at a price, respectively, of 0.40 per ordinary share and 0.33 per savings share, up to the limits allowed by law, for an equivalent amount of approximately 148 million. Based on the results of the tender offer, Telecom Italia Media purchased 364,251,922 ordinary shares and 6,107,723 savings shares equal, respectively, to 10% of ordinary share capital and 10% of savings share capital of Telecom Italia Media;

on October 18, 2005, the subsequent reduction in Telecom Italia Media share capital by canceling the treasury stock bought back.

All of the ordinary shares and savings shares were acquired in market transactions. As a result of the tender offer and after cancellation of the shares acquired, Telecom Italia now has direct control (60.4%) and indirect control (2.1% through Telecom Italia Finance S.A.) of 69.2% of the ordinary shares (up from 62.5%);

- on October 3, 2005, the Board of Directors of Telecom Italia Media approved the merger by incorporation of La7 Televisioni S.p.A. (a fully owned subsidiary) into Telecom Italia Media S.p.A..

As a result of the merger, effective January 1, 2006, Telecom Italia Media now holds direct control over MTV Italia and Telecom Italia Media Broadcasting.

The merger, which was also approved by the Board of Directors of La7 Televisioni S.p.A. on October 3, 2005, did not result in any changes to Telecom Italia Media's company bylaws, nor did it entail an increase in Telecom Italia Media's share capital, as Telecom Italia Media already held 100% of La7 Televisioni's shares which were subsequently cancelled without exchange, as a result of the merger.

4.1.5 DISPOSALS AND ACQUISITIONS OF SIGNIFICANT EQUITY INVESTMENTS IN 2005

For a description of disposals and acquisitions of significant equity investments in 2005 please see Note 1 Form and Content and Other General Information , Note 4 Business Combinations, Acquisitions of Minority Interests and Transactions between Companies Under Common Control , Note 9 Other Non-Current Assets and Note 16 Discontinued Operations/Assets Held for Sale of the Notes to the Consolidated Financial Statements.

4.1.6 RECENT DEVELOPMENTS DURING 2006

TIM Participações Partial offering of preferred shares

On May 16, 2006, TIM Participações S.A. filed a Preliminary Prospectus with the Brazilian Comissão de Valores Mobiliários (the Brazilian Securities Commission) and announced the intention to file a shelf registration statement on Form F-3 with the U.S. Securities and Exchange Commission for the sale of preferred shares of TIM Participações. The proposed offering of preferred shares will only comprise the sale of a portion of shares owned by TIM Brasil. The Telecom Italia Group will maintain control of TIM Participações through its current 81.19% stake of ordinary voting shares, none of which will be included in the offering.

For a description of other recent developments please also see Note 40 Subsequent Events and Note 45 Additional U.S. GAAP Disclosures of the Notes to the Consolidated Financial Statements.

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4.1.7 OVERVIEW OF THE TELECOM ITALIA GROUP'S MAJOR BUSINESS AREAS

The following is a chart of the Telecom Italia Group's Business Units as of December 31, 2005:

-
- (1) On October 5, 2005, the Board of Directors of Telecom Italia decided to accelerate the process launched in December 2004, and approved a fully integrated business model designed to ensure the best possible service to customers in compliance with applicable regulations. The resulting "One Company" organizational model replaces a model that employs separate Wireline and Mobile Business Units, thereby converging responsibility for the development of the fixed telephony, mobile telephony and Internet services businesses into a single organizational unit. The unification of the management of the business, as well as the unification of the management of the corporate structure, took effect immediately.
 - (2) On April 4, 2005, the Boards of Directors of Telecom Italia and Telecom Italia Media authorised the restructuring of the Telecom Italia Group's Internet business. As a result of this, on June 1, 2005, Telecom Italia acquired all of Telecom Italia Media's Internet activities (Nuova Tin.it and Matrix).
 - (3) On February 24, 2005, TIM proceeded to spin off the corporate operations relating to the domestic mobile communications business to Tim Italia S.p.A.. The merger of TIM with and into Telecom Italia took effect on June 30, 2005, while the merger of Tim Italia with and into Telecom Italia took effect on March 1, 2006.
 - (4) On October 3, 2005, the Board of Directors of Telecom Italia Media approved the merger by incorporation of La7 Televisioni S.p.A. into Telecom Italia Media S.p.A.. The merger became effective on January 1, 2006.
 - (5) On April 5, 2005, Olivetti Tecnost S.p.A. was renamed Olivetti S.p.A..

The following companies are considered assets held for sale and are now included in Other Activities:

- **Gruppo Buffetti** (previously included in the Media Business Unit); on September 26, 2005, Telecom Italia Media signed a contract with Dylog Italia S.p.A. and Palladio Finanziaria S.p.A. for the sale of Telecom Italia Media's 100% stake held in Gruppo Buffetti S.p.A.. The sale was finalized on January 11, 2006.
- **Corporacion Digital** (previously included in the Mobile Business Unit); on January 19, 2006, Telecom Italia through its subsidiary TIM International N.V., signed an agreement for the sale of 100% of the capital of the Venezuelan mobile operator, Corporacion Digital to Telvenco S.A.. On May 18, 2006, the necessary authorizations were received from the relevant Venezuelan authorities and therefore the completion of the acquisition can take place.

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The table below sets forth certain key data for each Business Unit.

	Period	Wireline (1)(2)	Mobile	Media (1)	Olivetti (4)	Other activities (2)(3)	Adjustments and eliminations	Consolidated Total
(millions of Euro, except number of employees)								
Revenues(5)	2005	17,802	12,963	180	452	1,680	(3,158)	29,919
	2004	17,431	11,712	168	590	1,635	(3,244)	28,292
Operating income	2005	4,566	3,661	(130)	(38)	(615)	55	7,499
	2004	4,756	3,850	(93)	17	(715)	(212)	7,603
Capital expenditures	2005	2,670	2,118	65	19	308	(7)	5,173
	2004	2,267	2,288	39	15	393		5,002
Number of employees at the year-end(6)	2005	55,990	20,767	886	1,750	6,091		85,484
	2004	54,090	18,743	1,077	2,109	6,601		82,620

- (1) On June 1, 2005, Telecom Italia acquired all of Telecom Italia Media's Internet activities (Nuova Tin.it and Matrix); as a result the Internet activities are included in the Wireline Business Unit for all periods presented, while they have been considered as discontinued operations in the Media Business Unit.
- (2) The operating activity IT Group is no longer presented since it is now included in the Wireline Business Unit and in Other Activities following the merger of IT Telecom with Telecom Italia which took place at the end of 2004.
- (3) Entel Bolivia is included in Other Activities.
- (4) On April 5, 2005, Olivetti Tecnost S.p.A. changed its name to Olivetti S.p.A..
- (5) Revenues are total revenues of the various business units of the Telecom Italia Group before elimination of intercompany sales (but after elimination of sales between companies within the same major business area).
- (6) The number of employees at year-end excludes employees relating to the consolidated companies considered as discontinued operations/assets held for sale, and includes temporary employees. For purposes of comparison with December 31, 2005, the number of employees at December 31, 2004 has been adjusted to include as discontinued operations/assets held for sale those companies that are considered as such at December 31, 2005.

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The following table sets forth, for the periods indicated, certain selected statistical data for the fixed-line, mobile, internet and media businesses.

	As of December 31,		
	2003	2004	2005
Statistical Data:			
Wireline:			
Subscriber fixed-lines in Italy (thousands)(1)	26,596	25,957	25,049
<i>of which: ISDN equivalent lines in Italy (thousands)(1)</i>	<i>6,027</i>	<i>5,805</i>	<i>5,459</i>
Broadband Access(2):			
• in Italy (thousands)	2,040	4,010	5,707
• abroad (thousands)	160	420	1,313
Voice Offers in Italy (thousands)(3)	5,547	5,883	6,392
Page views Virgilio (millions)	6,612	7,902	9,842
Unique users Virgilio (average number)	12.0	13.9	15.7
Network infrastructure in Italy:			
• access network in copper (millions of km pair)	105.2	105.2	105.2
• access network and transport in fiber optics (millions of km of fiber optics)	3.6	3.7	3.7
Network infrastructure abroad:			
• European backbone (km of fiber optics)	39,500	39,500	51,000
Mobile:			
Mobile lines in Italy at period-end (thousands)(4)	26,076	26,259	28,576
Foreign mobile lines at period-end (thousands)(5)	8,304	13,588	20,171
Total mobile lines at period-end (Italy + foreign in thousands)(5)	34,380	39,847	48,747
GSM coverage in Italy (% of population)	99.8	99.8	99.8
Media:			
La7 average audience share for the year (%)	2.2	2.4	2.7
La7 average audience share for the month of December (%)	2.2	2.6	3.1

(1) Data exclude internal lines.

(2) Number of contracts.

(3) Number of contracts; data include Teleconomy, Hellò and other Business voice offers.

(4) Includes TACS, GSM and UMTS services, including Prepaid Customers, and excludes silent lines.

(5) Comprises foreign lines of the subsidiaries included in the Mobile Business Unit and excludes those of the mobile subsidiaries considered as discontinued operations/assets held for the sale.

4.1.8 UPDATED STRATEGY

On March 8, 2006, we set out our priorities for the 2006-2008 period.

Changes in the demand for telecommunications services, increased competitive pressure and technological breakthroughs are progressively eroding the traditional distinctions between fixed and mobile business areas. We have long seen a strategy of convergence as the means of developing a sustainable long-term competitive advantage.

As a result we decided to accelerate the process launched in December 2004, building a fully integrated business model (the One Company Model) in the conviction that this will ensure the best possible services to customers, in accordance with prevailing regulations. The resulting One Company organizational model replaces the separate Wireline and Mobile Business Units, with the responsibilities for the development of the fixed telephony, mobile telephony and internet services businesses converging into a single organizational unit.

Our strategy is based on five pillars to support the growth of the Group and the evolution of profitability.

- **Convergence synergies:** due to the Telecom Italia/TIM merger and the accelerated integration of organization and operations, we plan to improve our ability to extract operating expenditures (opex)

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and capital expenditures (capex) synergies. We plan to have 1.3 billion of opex and capex savings in 2006 that will be largely reinvested to support growth in the new convergent scenario.

- **Employee productivity and reskilling:** we plan to increase employee productivity: in 2006 we plan to reduce our domestic group employees to approximately 68,300. We also plan to reskill our employees through a new skills development program, a competencies updating program and professional training.
- **Advanced network deployment:** in 2005, our network was based on common transport and IP infrastructures, common IT infrastructures, and supported an accelerated deployment of new technologies and services innovation. In order to improve the quality of service and to enable new services, we plan to deploy our network towards increased wireline/wireless access capacity, on demand bandwidth, integrated BSS and OSS systems, full IP network and integrated service platform for service creation, distribution and control.
- **Loyalty and retention:** we plan to strengthen customer loyalty through an upgraded customer relations model built on a needs-based customer segmentation and a multicontact approach (phone, web, mobile). We have a set of specific projects to accelerate service quality improvements.
- **Marketing leadership and growth:** we plan to increase our customer value through the delivery of communication services (e.g. voice, internet access, connectivity, etc.) and contents (music, sport, games, movies, infotainment, etc.) through different access technologies (e.g. POTS, ADSL, VDSL, UMA, BWA, DVB-H, HSDPA, 2G and 3G mobile access) on different kinds of devices (e.g. mobile phone, PDA, UMA phone, fixed phone, PC, TV). We also plan to leverage our network capabilities to expand our ICT offering towards business continuity, collaboration tools, advanced messaging, remote data storage, mobile office solutions and security solutions.

There can be no assurance that these objectives will actually be achieved.

While implementing the integrated One Company organizational model which is expected to anticipate the sector trends and provide us with a competitive advantage, we maintain a specific approach to the fixed and mobile markets, which are still characterized by specific competitive and regulatory contexts.

Wireline business

In Wireline, the main focus is on broadband development and customer retention. At the end of 2005, the customer base of broadband access lines was 5.7 million in the domestic market and 1.3 million in the European markets (France, Germany and The Netherlands). Broadband access services (Alice and Alice Business) have supported continued growth. New voice packages, including flat rates on both POTS and VoIP lines, and innovative integrated solutions for business clients were also introduced.

Our Wireline strategy continues to be driven by defense of market share in voice traffic, a strong emphasis on data/Internet growth and the development of broadband content and services, while maintaining a strong focus on obtaining cost efficiencies.

In particular, we intend to:

- maintain the domestic leadership in our core business (voice services, Internet access, data transmission services for businesses, national and international wholesale services); on voice, the process of migrating an increasing portion of our customers to flat rate packages will be the key to ensure the success of our retention strategy;
- strengthen our leadership in service innovation and increase the penetration of broadband services, through dual play (voice + broadband access) offers, triple play (voice + broadband access + IPTV) offers, and also quadruple play offers (fixed and mobile voice + broadband access + IPTV). These services will be supported by increased bandwidth, as we expect to deploy the ADSL2+ technology in 2006 and the VDSL2 technology in the main Italian cities by 2007, thus providing access speeds of up to 20 Mbit/s and 50 Mbit/s, respectively;
- consolidate our operational capabilities with the objective of offering best in class service levels to our customers and leverage opportunities to retain our client base by enhancing customer loyalty (through customer relationship management and customer contact);

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- run efficient operations and continue our cost-cutting program (personnel, real estate, general and administrative, network);
- maintain competitive services and focus investment on enhancing network evolution towards optical transport and IP (Internet Protocol) services; and
- expand the presence in selected areas throughout Europe (such as Germany and France) with the offer of broadband access and value-added services by capitalizing on domestic expertise. We expect to increase the geographic coverage in both France and Germany, while maintaining a focus on full LLU access.

There can be no assurance that these objectives will actually be achieved.

Italian mobile business

Mobile Italy's strategy is focused on maintaining its leadership and achieving sustainable and profitable growth in the Italian wireless market through:

- continuous innovation and improved segmentation of voice and Value Added Services (VAS) offers; we believe this should enable Mobile Italy to retain or improve its market share and to achieve leadership in the UMTS services market;
- strong customer care, able to respond and anticipate customer needs with a segmented approach; and
- full enhancement of the potential of the UMTS network and development of mobile broadband technologies (such as HSDPA) and of DVB-H (mobile TV) services. These are expected to enable the provision to mobile customers of value added services and content now available to fixed line customers, due to the development of convergent platforms.

The main strategic tools for the achievement of such objectives are:

- development of synergies between fixed and mobile services both on the revenue side, by launching convergent services, and on the cost side, by eliminating duplication and achieving cost efficiencies on capex and opex;
- innovative marketing propositions, aimed at generating new and segmented offers to increase voice traffic and VAS usage;
- a multichannel and integrated approach to caring and distribution, tailored for different customer needs/profile, capitalizing also on fixed line service push distribution channels; and

- focus on innovative capex, enabling us to retain our leadership in network quality and to provide our customers with attractive wireless broadband services.

There can be no assurance that these objectives will actually be achieved.

Brazilian Mobile business (TIM Brasil)

In 2005, TIM Brasil further strengthened its market position and outperformed the Brazilian market line growth also due to its ability to attract high value customers. After an increase in mobile penetration by 10 percentage points to 47%, the Brazilian market is expected to continue growing and to reach a penetration rate of approximately 60% in 2008. In this context, TIM Brasil's strategy will remain focused on maintaining its leadership in the high value customer segment and to stabilize or slightly increase market share, through:

- deeper segmentation of the offer for both consumer and business customers;
- continuous innovation in Value Added Services, which accounted for 6% of service revenues in 2005 and provides significant growth opportunity; this is enabled by TIM Brasil's nationwide GSM/EDGE coverage;
- shorter time to market and greater efficiency due to TIM Brasil's plug and play strategy, which enables it to share resources and know-how with the domestic Italian business;
- improved customer care, also leveraging on its extensive distribution channel; and

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- increased focus on quality of coverage, rather than pure extension (91% of urban population already covered).

Economies of scale and strict cost control should also allow TIM Brasil to further improve its profitability.

There can be no assurance that these objectives will actually be achieved.

Telecom Italia Media

In 2005, Telecom Italia Media completed its transition to a focused media company by selling its Internet operations and the Buffetti Group (the sale of the latter was finalized in January 2006) and executed the buy-back of ordinary and saving shares and merger by incorporation of La7 Televisioni S.p.A.. Telecom Italia Media is consolidating its position as a multimedia and multiplatform broadcaster with the aim of establishing a benchmark for its industry.

In particular, the strategy to be implemented over the 2006 – 2008 period includes:

- La7 and MTV Free to Air: consolidate distinctive publishing and competitive positioning to increase advertising revenues faster than audience share and programme costs;
- Multimedia and Multichannel: full exploitation of relevant contents through all distribution platforms; and
- Digital Terrestrial Television: consolidate the second player position completing the Pay Per View contents/channel offer and testing a new interactive and premium offer.

There can be no assurance that these objectives will actually be achieved.

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4.1.9 THE ORGANIZATIONAL STRUCTURE

The following diagram highlights the organizational structure of the Telecom Italia Group as of the date of this Annual Report:

-
- (1) On November 25, 2005, the Services for the Judicial Authority Service Unit was set up and reports directly to the CEO, Carlo Orazio Buora. The unit is headed by Aldo Cappuccio who is responsible for the coordination and relations with the Italian judiciary at the Group level and the services rendered to the Judicial Authorities for wireline and mobile telecommunications.
 - (2) As from January 23, 2006, Gustavo Bracco is responsible for the Security Service Unit as well as being in charge of the Human Resources and Organization Group Function.
 - (3) The consortium company is in charge of the internal auditing activities of the Group. In April 2006, the consortium company was renamed *Telecom Italia Audit and Compliance Services*.

Our recent adoption of the One Company model organizational system has resulted in a overall reorganization of the Group which, since October 5, 2005, has been structured as follows:

- **Central Functions:** in charge of managing the functioning of the Telecom Italia Group;
- **Operations:** responsible for the management and development of fixed telecommunications, mobile telecommunications and internet services;
- **Business Units:** responsible for the development of the Media and Olivetti businesses.

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Specifically, the following individuals report to the Chairman, Marco Tronchetti Provera:

the Chief Executive Officer, Carlo Orazio Buora, who is responsible for activities connected with the direction and control of the business as well as the overall management of cross-over business issues;

the Chief Executive Officer of Operations, Riccardo Ruggiero.

The following also report directly to the Chairman:

the Central Functions of *Public and Economic Affairs, Communication and Image, Progetto Italia, Investor Relations, Telecom Italia Latam and General Counsel*;

the *Media* Business Unit with its principal areas of business being journalistic information, TV production, TV and web content offerings headed by Enrico Parazzini.

The *Olivetti* Business Unit, headed by Giovanni Ferrario reports directly to the CEO, Carlo Orazio Buora. This business unit operates in the market of specialized applications for the banking field and retail information systems for gaming, lotteries and e-vote systems as well as in the research, development and production of products using silicon technology (from ink-jet heads to Micro-Electro-Mechanical Systems).

The Central Functions with Operations and Business Units retaining responsibility for economic results and businesses are divided into **Group Functions** and/or **Service Units** for the purpose of ensuring a more direct focus on cross-over activities in relation to their role of strategic governing and/or common operating service.

Committees

One of the most important tools for the management and the operational integration of the Group is the *Committee System* which has recently been revised with the aim of:

monitoring the implementation of strategies and the development of plans and results;

ensuring the overall coordination of business actions and the management of the relative cross-over business issues;

building up the necessary operating synergies between the various functions involved in the technological, business and support processes; and

supporting the integrated development of the innovation processes of the Group.

In particular, the new *Committee System* of the Group includes:

- the *Management Committee*, which coordinates the Group's activities and ensures a unified approach to the development and implementation of business strategies;
- the *Investments Committee*, which is entrusted with approving investments that exceed specific delegated limits;
- the *Business Reviews Committee for Operations, Media and Olivetti*, which, for each business segment, analyzes forecasts, results and operating progress and examines the advances made on the most important projects and action plans;
- the *Technological Committee*, which ensures an integrated approach to innovation and technological development processes;
- the *IT Governance Committee*, which defines the guidelines for the information strategies of the Group, addresses IT strategic decisions and investments consistently with business needs, monitors progress on the most important IT projects, the quality of solutions and cost effectiveness;
- the *IT Risk Management Committee*, which ensures the global administration of IT risk at the Group level.

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The Wireline Business Unit operates on a national level as the consolidated market leader in wireline telephone and data services for final retail customers and wholesale providers. On an international level, Wireline develops fiber optic networks for wholesale customers (mainly in Europe and South America) and innovative Broadband services in large metropolitan areas in France, Germany and The Netherlands.

Aggressive market competition continued during 2005, in particular for national traffic, and was countered with new plans offered as part of actions to retain customers.

The Wireline Business Unit accounted for gross revenues of 17,802 million in 2005 and 17,431 million in 2004. The 2005 gross revenues represented positive growth of approximately 2.1% which is one of the most important goals of the Wireline Business Unit's strategy.

The organizational structure of the Wireline Business Unit as of December 31, 2005 was as follows:

Telecom Italia Wireline	WIRELINE National Subsidiaries	International Subsidiaries
Wireline TLC services:	Loquendo S.p.A.	BBNED group
	Matrix S.p.A.	Liberty Surf group
• Retail telephone	Nuova Tin.it S.r.l.	HanseNet Telekommunikation GmbH
	Path. Net S.p.A.	Telecom Italia Deutschland Holding GmbH
• Internet	Telecontact Center S.p.A.	
• Data Business		
• National Wholesale	Telecom Italia Sparkle group:	

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- Telecom Italia Sparkle S.p.A.
- Telecom Italia San Marino S.p.A. (formerly Intelcom San Marino)
- Pan European Backbone
- Telecom Italia Sparkle of North America Inc.
- Telefonía Mobile Sammarinese S.p.A.
- Thinx S.r.l.
- TMI group
- Telecom Italia Sparkle Singapore
- Latin American Nautilus group
- Telecom Italia Sparkle France S.A.S.
- Mediterranean Nautilus group
- Med-1 group

V KEY ISSUES IN ITALY

- The Wireline Business Unit is focused on switching its customers from traditional to innovative technologies to enlarge IP services and applications. The Wireline Business Unit intends to expand its large penetration in the broadband retail market through ADSL connections offered respectively to the consumer and SOHO (Small Office Home Office) markets with the package Alice .
- This strategy has had significant success in Italy with 5.7 million broadband points of access sold to the retail and the wholesale market at December 31, 2005 (approximately 4 million at December 31, 2004), of which approximately

4.8 million points of access have been sold to retail customers. The growth is attributable to the success of various tariff structures geared to retail customers (consumer and business).

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- The Wireline Business Unit is seeking to grow revenues by developing new services, based on innovative uses of its fixed network, such as video communication and SMS (Short Message Service) for fixed telephones. In particular, commercial efforts have been made to support innovative telephones sales, e.g. Aladino (with functions and design very close to last generation mobile phone) and video communication terminals.
- In the voice area the key issue is to continue developing voice offers (Teleconomy, Hellò and other business customized offers) to support loyalty and retention and win back customers which have moved to other service providers.

V SUBSCRIBERS IN ITALY

The table below sets forth, for the periods indicated, certain domestic subscriber data of Wireline.

	As of December 31,		
	2003	2004	2005
Statistical Data:			
Wireline:			
Subscriber fixed-lines in Italy (thousands)(1)	26,596	25,957	25,049
<i>of which: ISDN equivalent lines in Italy (thousands)(1)</i>	<i>6,027</i>	<i>5,805</i>	<i>5,459</i>
Broadband Access(2):			
• in Italy (thousands)	2,040	4,010	5,707
• in Europe (thousands)	160	420	1,313
Voice offers in Italy (thousands)(3)	5,547	5,883	6,392
Page views Virgilio (millions)	6,612	7,902	9,842
Unique users Virgilio (monthly average number) (millions)	12.0	13.9	15.7
Network infrastructure in Italy:			
• access network in copper (millions of km pair)	105.2	105.2	105.2
• access network and transport in fiber optics (millions of km of fiber optics)	3.6	3.7	3.7
Network infrastructure abroad:			
• European backbone (km of fiber optics)	39,500	39,500	51,000

(1) Data exclude internal lines.

(2) Number of contracts.

(3) Number of contracts; data include Teleconomy, Hellò and other Business voice offers.

As of December 31, 2005, the Wireline Business Unit had approximately 25.0 million fixed subscriber lines, including approximately 17.0 million residential lines (including multiple lines for ISDN), approximately 7.8 million business lines (including multiple lines for ISDN), and approximately 191,000 public telephones lines (including ISDN equivalent lines).

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As of December 31, 2005, the Wireline Business Unit had approximately 5.5 million ISDN equivalent lines. The number of subscribers is expected to slowly decline as marketing is focused on ADSL lines which provide greater speed on the Internet. This is evidenced by significant growth in broadband access.

As of December 31, 2005, 57% of the public telephones in service were equipped with phone card readers. The density of public telephones in Italy is among the highest in the world, with about one public telephone per square kilometer and approximately 3.3 public telephones for every 1,000 inhabitants.

V **WIRELIN STRATEGIC BUSINESS AREAS**

- ***Retail Telephone***

Retail Telephone services consist mainly of services offered using traditional technology (PSTN and ISDN). Main retail telephone services include: access to the network, traffic (in terms of minutes of retail traffic and tariff packages), equipment rental and assurance and value added services for voice.

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Revenues in the retail telephone segment consist mainly of traffic revenues, fee revenues and sales revenues. Traffic revenues are generated from minutes of traffic carried on the network (volumes), tariffs and fees for tariff packages. Fees include access fees such as basic monthly subscription charges, fees for additional services and for equipment rental and assurance. Sales revenues relate to sales of equipment.

Revenues from retail telephone were 10,095 million in 2005, a decrease of 4.7% compared to 2004 (10,591 million in 2004). The reduction was related mainly to traffic revenues (volume decrease, repricing and promotions) and access fees, due to the significant impact of competition and due to the migration of volumes to the mobile network. The market share of Voice traffic volumes declined to 71.6% at December 31, 2005 (73.1% at December 31, 2004). In this segment during 2005 the Wireline Business Unit continued to focus on measures to support revenues, i.e. Value Added Services, traffic packages (voice offers), loyalty and retention schemes.

- ***Retail Internet***

Retail Internet services consist mainly of ADSL services (connections, traffic, services, equipment and portals) and traditional Internet traffic (such as dial-up), which is declining as ADSL is growing.

During 2005, the Wireline Business Unit continued focusing its efforts on growing its ADSL mass-market base. In particular, in December 2005, Telecom Italia, in keeping with its commitment to develop innovative broadband services, launched Alice Home TV (Internet Protocol TV or IPTV), which carries, through the phone connection, films, sport, music and news to the home TV as well as providing access to broadband Internet. At the end of 2006, approximately 8 million families will be able to access IPTV.

Revenues from Retail Internet were 1,197 million in 2005, an increase of 176 million, or 17.2% from 1,021 million in 2004. Revenues from Retail Internet consist primarily of revenues from ADSL (mass market broadband access) for access fees and traffic, and revenues from Internet dial-up traffic revenues. Revenues from ADSL (including revenues from Portal services) were approximately 865 million, increasing strongly by 40% over 2004 (618 million in 2004), mainly due to the larger customer base and traffic. Revenues from Internet dial-up traffic decreased from 403 million in 2004 to 332 million in 2005 due to migration to Internet connections using broadband access.

- ***Data Business***

Data Business services consist of data transmission and network services for business customers, leased lines, equipment for data services and value added services.

The Wireline Business Unit provides a broad range of data transmission and web application services supported by a wide spectrum of technological platforms ranging from traditional to advanced platforms based on broadband access (Synchronous Digital Hierarchy or SDH, the European standard for high speed digital transmission and XDSL).

Leased lines are trunk lines offering a customer-subscriber a permanent connection for telecommunication services between two geographically separate points. This kind of connection can be used to handle high volume voice, data or video transmission.

Value added services related to data consist primarily of web based services, outsourcing and security services. Data services consist primarily of data transmission and network services for business customers.

Revenues from Data Business (Data services, Leased Lines for retail customers, Value added services related to Data and Data Equipment) were 2,107 million in 2005, an increase of 125 million, or 6.3% from 1,982 million in 2004. In particular, the growth in services revenues was driven mainly by value added services (web services, outsourcing and security services) and by innovative data services: VAS increased by 25.3% in 2005 compared to 2004 (550 million in 2005 and 439 million in 2004); innovative data services increased by 15.7% in 2005 compared to 2004 (723 million in 2005 and 625 million in 2004).

Revenues from traditional Data services (data transmission using data packet technology) and leased lines decreased from 620 million in 2004 to 553 million in 2005 (a decrease of 10.8%), mainly due to customer migration to broadband services and repricing.

Revenue from data equipment decreased to 281 million in 2005 from 298 million in 2004 (a decrease of 5.7%).

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- **European Broadband Project**

With the European Broadband Project, we have created an innovative offer of broadband access and services in a number of large metropolitan areas in Europe. The plan, started in 2003, currently includes France, Germany and The Netherlands through the controlled companies Telecom Italia S.A., HanseNet and BBNE.

Revenues from the European Broadband Project were 566 million in 2005 (an increase of 109.6% compared to 2004). The European Broadband Project had a further boost in growth by the purchase of Liberty Surf Group in France on May 31, 2005. Wireline s European broadband customers at December 31, 2005 were approximately 1.3 million units (an increase of 893,000 compared to 2004), while total customers, including narrow-band, were approximately 1.8 million units.

- **Wholesale Services**

Wholesale services consist of national and international services to other domestic and international operators. Services offered to other domestic operators (wireline and wireless operators as well as Internet service providers) consist mainly of interconnection to Telecom Italia s network, in terms of access and traffic (carried traffic and transits), broadband access (ADSL and XDSL access), and leased lines. Services offered to international operators consist mainly of traffic (carried traffic and transits) and data access.

Revenues from wholesale services were 3,525 million in 2005, an increase of 10.5% compared to 2004 (3,189 million in 2004). The growth has been particularly driven by International wholesale services which accounted for 1,576 million in 2005, increasing by 240 million (an increase of 18%) due to significant volumes of traffic carried for other operators. Revenues from Domestic wholesale services increased by 96 million (an increase of 5.1%) due to continued growth in Data offers, especially broadband, and LLU services.

V TRAFFIC AND TARIFFS

The table below sets forth, for the periods indicated, certain traffic data for Wireline.

	Year ended December 31,		
	2003	2004	2005
Wireline total traffic (Retail and Wholesale) (billions of minutes)	226.6	192.0	185.1
<i>of which:</i>			
<i>National(1)</i>	215.2	179.1	171.3
<i>International(2)</i>	11.4	12.9	13.8
Retail Traffic(3):			
Average minutes of use per fixed line subscriber in Italy during period(4)	4,127	3,935	3,722
<i>of which:</i>			

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<i>Local traffic during period (in average minutes)(5)</i>	<i>2,971</i>	<i>2,749</i>	<i>2,530</i>
<i>Long distance traffic during period (in average minutes)</i>	<i>1,156</i>	<i>1,186</i>	<i>1,192</i>

(1) Data include total retail traffic (international outgoing traffic excluded) and total domestic wholesale traffic. Data exclude the traffic of Nuova Tin.it and Matrix.

(2) Data include international retail outgoing traffic and total international wholesale traffic.

(3) Retail traffic consists of traffic from Telecom Italia customers for local calls, long distance national and international calls and calls to mobile phones.

(4) Data include total retail fixed outgoing traffic (including international outgoing traffic and fixed outgoing traffic to the mobile networks).

(5) Data include district and Internet dial-up traffic.

Domestic Fees and Tariffs. Since November 1, 1999, our traffic tariffs have been based on a per second billing system with an initial fixed charge (the call set up). The tariff per call set up (VAT included) varies depending on the kind of call: 0.0787 for local, long distance and fixed to mobile calls and 0.3098 for international calls. The tariff per second varies according to the kind of call, the time of day and the day of the week. Since December 1997, we have introduced tariff packages for residential and business customers which provide for discounts on national and international traffic tariffs and additional rental charges.

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Traffic packages mainly consist of Teleconomy and Hello offers for the Mass Market and SOHO customers. Further customized offers are provided to business customers.

For business customers, the Wireline Business Unit has introduced specific offers for companies with high volumes of traffic, allowing companies to choose among a variety of price plans.

Residential offers. In 2005, we introduced new offers for retail customers, including Teleconomy no problem, which, for a subscription fee of 15.00 per month (including VAT), allows the customer to make unlimited national traffic calls. Another offer is Teleconomy Famiglia which allows the customer, for a subscription fee of 5.00 per month (including VAT), to call at lower prices three cellular numbers of a particular operator. The last offer, Teleconomy Internet, provides, for a subscription fee of 12.00 per month (including VAT), a narrow band flat connection. The VoIP offers range has been enlarged with Alice My Voice.

Business offers. Offers introduced in 2005 included: Opzione Mondo Open Business relating to international traffic, Opzione on line Business, which is a narrow band flat offer, and, in order to enlarge the VoIP offer, the Alice Business Voice.

Domestic Tariff Rebalancing. We commenced rebalancing our tariffs in 1991 and made various adjustments until 1997. The National Regulatory Authority has been responsible for tariff regulation since December 1998 and on July 28, 1999 introduced a price cap mechanism designed to promote productivity and efficiency for the Telecom Italia Group, as the incumbent operator in markets with a low level of competition. The price cap is a formula that limits the incumbent's ability to modify the overall level of its prices. The formula is defined as RPI-X, where RPI is the Retail Price Index and X is a pre-defined level of efficiency fixed by the NRA. Therefore, RPI-X is the average percentage variation which the incumbent can apply to its prices. In real terms, at a given level of inflation, RPI, the incumbent is obliged to reduce its prices by X. The higher the level of X, the greater the obligation to reduce prices. If the incumbent wants to maintain the same marginal return with lower prices, it is obliged to increase its efficiency (by a level of X). The price cap mechanism may also be used as a sub-cap, e.g., as a price cap on service(s) of particular importance. For example, if the NRA did not want a raise in monthly rental fees, then this would be achieved by setting a sub-cap of RPI-RPI for monthly rental fees.

The price cap was applied until December 31, 2002 to a whole basket of public voice telephone services composed of activation fees, basic subscriber charges, local and long distance calls and international tariffs.

On July 23, 2003, the NRA introduced a new price cap mechanism, also referred to as a safeguard cap, which is intended to control the maximum prices we may charge for voice services for the four year period 2003-2006. In 2003 the NRA identified three separate baskets:

- access;
- local and long distance calls; and

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- fixed to mobile traffic, limited to the fixed call segment which is retained by Telecom Italia (the Retention segment).

Furthermore, for the access basket a sub-price cap for residential subscription charges was also established.

The NRA fixed the value of X as follows:

- $X=0\%$ for the access basket;
- $X=RPI$ for the sub-price cap for residential subscription charges and for the local and long distance calls basket; and
- $X=6\%$ for the fixed to mobile traffic (the Retention segment).

Such new price caps cover:

- basic subscriber charges and other access charges RPI (Retail Price Index) + 0%, as well as a sub-price cap for residential subscription charges of $RPI - RPI$ ($RPI - RPI=0$);

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- local and long distance calls with a cap equal to RPI-RPI; and
- fixed to mobile traffic, limited to the fixed call segment belonging to Telecom Italia (the Retention segment) with a cap equal to RPI-6%.

The basket of public voice telephone services includes one-off fees, monthly fees, domestic and fixed to mobile standard tariffs.

In accordance with the price cap mechanism, during 2005 we implemented the following tariff changes:

- an increase of 85 million in access charges for business customers, representing an increase of 4.9% for this customer segment, although representing an increase of only 1.9% for the whole residential and business customer segment;
- in local traffic the call set-up has been brought in line with national traffic (an increase of about 27%) while the prices per minute have been reduced (a decrease of about 25%) to respect the safeguard cap that expenses for customers be unchanged; and
- a reduction of fixed to mobile traffic tariffs with consequent reduction of Retention (that is the amount due to Telecom Italia) equal to approximately 19 million (a 3.8% reduction compared to 2004).

International Traffic

The table below sets forth, for the periods indicated, information with respect to incoming and outgoing traffic, including direct dial and operator assisted calls and mobile traffic.

	Year ended December 31,		
	2003	2004	2005
Total outgoing traffic (millions of minutes)	3,682	3,990	4,176
Growth in outgoing traffic (%) ⁽¹⁾	8.1	8.4	4.7
Total incoming traffic (millions of minutes)	3,299	3,445	3,480
Growth in incoming traffic (%) ⁽¹⁾	(14.1)	4.4	1.0
Total international transit traffic (millions of minutes)	4,382	5,452	6,051
Growth in international transit traffic (%) ⁽¹⁾	46.3	24.4	11.0

(1) For each of the years ended December 31, the percentage growth figures represent growth per annum over the prior year's end.

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The increasing volumes in international traffic from 2003 to 2005 was mainly due to the growth of cross-border activities (i.e. import/export, tourism, immigration).

During 2005 outgoing international traffic increased by 4.7% compared to 2004. The outgoing international traffic is mostly concentrated in communications traffic with Germany, France, Romania, Switzerland, United States, United Kingdom, Albania and Ukraine, which together accounted for approximately 44% of total minutes in 2005.

Incoming international traffic is divided into two general categories: traffic incoming on the fixed network and traffic incoming, or deemed to be incoming, on the mobile network. Such incoming, or deemed to be incoming, traffic, which originates outside Italy, utilizes the fixed network before terminating on the mobile network. With respect to the mobile network, the distinction between incoming or deemed to be incoming is that incoming traffic is the traffic generated abroad and directed to the mobile network through the fixed network in Italy, while traffic which is deemed to be incoming is traffic generated in Italy through the use of international calling cards. Because of the use of international calling cards, such traffic is deemed to be incoming from an international network although the call may be generated in Italy.

The traffic incoming on the mobile network increased by 28 million minutes compared to 2004 (an increase of 2.0%) while the traffic incoming, or deemed to be incoming, on the fixed network increased by 7 million minutes compared to 2004 (an increase of 0.3%).

In 2005, wholesale international activities were focused on managing international transit traffic that resulted in volume increases of 599 million minutes (an increase of 11.0%) compared to the previous year. This performance

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was due to the acquisition of new wholesale customers through 91 new interconnections (39 of which in Voice Over IP), the reduction of the costs through new techniques of transportation as VoIP (1.5 billion of minutes), and finally to new hubbing strategies in Africa, Middle East and Eastern Europe.

During 2005, certain adjustments in International Traffic tariffs were implemented (application of specific prices for calls made to mobile numbers in Libya, Lithuania, Ukraine, China, Taiwan, Colombia and Mexico).

International Settlement Arrangements. We derive revenues from foreign telecommunications operators for incoming calls which use the Telecom Italia Group's network. We have bilateral settlement arrangements with other international telecommunications operators under the general auspices of the ITU (International Telecommunication Union). Because incoming and outgoing international traffic are relatively equal, our net payments on international accounting rates are negligible. This has the effect of limiting our exposure to changes in currency exchange rates. The exposure to changes in currency exchange rates has also been reduced due to the adoption of the euro.

Interconnection with Other Operators

On March 22, 2003, the NRA approved the introduction of the Network Cap mechanism to regulate interconnection tariffs until the end of 2006. The mechanism will govern the amounts we can charge other operators that want to utilize our network to provide telecommunications services. From the 2003 Reference Offer (RO), the market has gained greater transparency with respect to the arrangements relating to interconnection services, allowing other operators to rely on stable economic values in preparing their business plans.

The Authority has defined five main services baskets with relative caps, in the form of Retail Price Index (RPI) X:

- SGU (Local exchange interconnection and interconnection kit and circuits) = RPI 8%;
- SGT (Single transit interconnection) = RPI 6%;
- 2SGT (Double transit interconnection) and international transit by SGT = RPI 3.75%;
- Ancillary services (e.g. number portability charging, Carrier Pre-Selection (CPS) charging) = RPI RPI;
- Local Loop Unbundling (LLU): as of December 31, 2005, the NRA has not defined the caps for this service. This was due to the NRA's developing the definition for the new market of unbundled access (including shared access) to copper network and sub-network for vocal and broadband services (market No. 11).

With respect to LLU, until the last Order (4/06/CONS) on market No. 11, the NRA in the Order 3/03/CIR had outlined a network cap mechanism to be implemented from January 1, 2004 through December 31, 2006 aimed at moving from historic costs to Long Run Incremental Costs (LRIC). LRIC of the access network are likely to be higher than historic costs. Currently, we apply an LLU price of 8.30/month which is the lowest in Europe and is significantly lower than our retail access price. Prior to implementing this price, our LLU price was 10.79 per month for POTS (Plain Old Telephone Service) line and 11.10 per month for ADSL line. Regarding implementation, the Italian LLU market is one of the fastest growing LLU markets in Europe with almost 1,117,000 fully unbundled lines on December 31, 2005 (Italy is second after Germany where LLU started about two years before), representing an increase of about 357,000 lines compared with the end of 2004. Starting from the new Order (4/06/CONS) on market No. 11, the LLU price will be defined by a network cap mechanism equal to RPI 4.75%.

In addition, we present the most detailed and complete LLU offer in Europe (physical LLU, sub loop unbundling, shared access and all different kinds of co-location) and we have satisfied all NRA requests in terms of equipment of the sites requested by Other Licensed Operators (OLOs). In 2005, the OLOs have increased the use of shared access lines and 141,000 lines were activated at the end of the year.

Starting from January 2005, we have adopted extraordinary and temporary actions for broadband access, dedicated carriage and network infrastructure wholesale services, for the two year period 2005-2006, with the aim of further developing the competitive framework.

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On March 9, 2005, the NRA approved the RO for the year 2005 that we published on October 29, 2004. The NRA provided, for some services in particular, the reformulation of the supply conditions (interconnection capacity, supplementary services to the interface, internal telephone exchange links) and financial conditions (Carrier-Preselection, invoicing for access to services on non-geographic numbering by other operators).

Our 2005 RO includes the conditions for Flat-Rate Internet Access Call Origination (FRIACO) service, partial circuits provisions, shared access and sub-loop unbundling, thus enabling a competitive development of Internet access and broadband services.

- FRIACO: we have been offering this service since 2001.
- Partial circuits: represent partial circuits from customer premises to the OLOs POP (Point Of Presence), as a segment of an end-to-end leased line. The NRA determined that economic conditions are to be set according to the price ceiling methodology that was established by the European Commission Recommendation C(1999) 3863 of November 24, 1999, and introduced the price ceiling into national legislation. For speeds and distances of partial circuit different from those included in the Recommendation, the prices are based, according to national as well as European accounting requirements, on Telecom Italia s own costs, evaluated according to the fully allocated current costs model.
- Billing and bad debt service: Telecom Italia must also offer billing to OLOs who decide not to bill the customers (*i.e.* customers are connected to the network through indirect access service) accessing their non-geographic services. Telecom Italia, as required by the NRA, fixed the charging level for the billing service at 2.9% calculated on the total revenues of each OLO s non-geographic service. With respect to bad debt, the level of risk and insolvency is subject to negotiation between Telecom Italia and the OLOs.
- The NRA in Order 1/05/CIR has pointed out the need to open a specific proceeding to determine the value for billing relating to Non-Geographic Number (**NGN**) services. Because of the NRA has not opened proceedings on NGNs despite several requests by Telecom Italia, after the expiration of the administrative term for the opening of the above proceeding, we announced that for the year 2006, the value for billing is fixed at 9.1%, which derives from the results of Regulatory Accounts for fiscal year 2004.

On April 28, 2003, the NRA approved rules which regulate the manner in which customers can request deactivation of the CPS service. The NRA determined that a client can send his deactivation request both to Telecom Italia and to the preselected OLO.

On December 12, 2004, the NRA published:

- the description of the Cost Accounting Methodology and of the cost accounting system; and
- the report of the Auditors on the Accounting Separation and the Regulatory Accounting of Telecom Italia for the Fiscal Year 2001.

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The Auditors concluded in this report that, for 2001, the Regulatory Accounting data issued by Telecom Italia had as a whole been issued in conformity with the appropriate methodological criteria required by law.

In 2005, we presented to the NRA the Accounting Separation and Regulatory Accounting for Fiscal Year 2004.

In compliance with EC Recommendation No. 2003/497 and with the Electronic Communication Code (Legislative Decree No. 259, dated August 1, 2003), on May 19, 2004, the NRA started the preliminary consultations concerning analyses of the 18 markets mentioned in the Recommendation and in the articles number 18 and 19 of the Electronic Communication Code. For details please see Item 4. Information on the Telecom Italia Group 4.3 Regulation .

In 2005, we set up interconnections with the networks of five additional operators, making a total of 60 operators with operating interconnection agreements at December 31, 2005.

During 2005, the following contracts were also signed or renewed:

- eight interconnection agreements;
- six additional reverse agreements, terminating calls on the network of another operator;

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- one hundred and five agreements to supply high-speed access services using xDSL technology;
- three carrier preselection contracts, one district carrier selection agreement and ten number portability agreements;
- four contracts for shared access service on the local network, and one contract for Local Loop Unbundling;
- eleven contracts to supply Digital Data Circuits or Partial Circuits; and
- nine agreements for fiber optics infrastructures.

V FIXED NETWORK**Domestic Network**

General. Our domestic fixed network is made up of 33 gateway areas (each gateway area has two points of interconnection which allows our fixed and mobile networks to exchange signals) and 628 main local switches (only for fixed OLOs). Each local switch belongs to only one of the 33 gateway areas. The long distance fixed network includes 3.9 million circuits, while the distribution fixed network includes 105.2 million kilometers of pairs over copper cable.

At December 31, 2005 the national network consisted of the following:

Exchange areas	Approximately 10,340
Switching areas	615, served by 628 line SGU (Urban Group Stages)
Gateway Areas	33
Copper access network	105.2 million kilometers-pair
Fiber optic access network	430,000 kilometers-line
Fiber optic carrier network	3.24 million kilometers-line
Direct dialing circuits	3.9 million
Network for direct digital circuits (PARD)	382,000 access points with speed up to 2 Mbit/s
Network for direct analog circuits (PARD)	90,000 access points
Frame Relay Accesses	85,000 gates at 2Mbit/s
PoP main data networks	32

SDH and ATM. We introduced SDH transmission technology into operation in the long distance fixed network in 1996 and introduced such technology into operation for its local fixed network during 1997. These transmission systems are operating on fiberoptics from 155 Mbit/s up to 10 Gbit/s. Work on the development of the national network (Long distance) which, by use of the latest generation of SDH technologies and the optical DWDM technology (Dense Wavelength Division Multiplexing) constitutes the basis for the transport network with a high transmission capacity capable of covering the entire Italian territory, continued during 2005. In order to reduce the number of fibers, DWDM systems have been used to multiply by a factor of 12 up to 40 the available

optical fiber band and the current transmission capacity, thus increasing the transport capacity of the connections. In November 2002 Wireline introduced a new generation of Optical Digital Cross Connect on the domestic wireline transmission backbone in order to progress with the transition from a national network based on a SDH rings architecture, towards the new generation of meshed ASTN (Automatically Switched Transport Network) optical backbone which started in 2003, continued during 2005 connecting over 31 cities (all the major cities of Italy) and will continue through 2006 (adding a further 38 nodes). By using the ASTN approach it is possible to build a multiservice platform with a high level of integration with the IP network.

The evolution of the transport network towards the optical network will make it possible to increase the operational capacity of all types of traffic, from phone calls to Internet traffic.

ATM switching technology, introduced in 1996, allows the transfer of information combining data, video and other services over public and private networks both domestically and internationally. Telecom Italia ATM/Frame Relay networks are overall networks that work together as a multiservice network, using SDH transmission systems as a physical layer. The ATM Network allows for the provision of ATM native services with access rates ranking from 2Mbit/s up to 155 Mbit/s. It also acts as a backbone for both the Frame Relay Access network (with access rates

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ranking from 64 kbit/s up to 2 Mbit/s), and for the DSL (Digital Subscriber Line) Network, used for the provisioning of xDSL services (ADSL High-bit-rate Digital Subscriber Line or HDSL) and SDSL. The ATM/Frame Relay networks allows access to IP and MPLS services (Multi Protocol Label Switching) by customers with access rate ranking from 64 kbit/s to 155 Mbit/s.

Network Quality and Productivity. Our investments in our domestic service network have enabled us to continue to reduce the average time required for the installation of new lines. The effectiveness rate of the fixed network is defined as the ratio of successful calls to the total number of call attempts, not including failures caused by the calling party's behavior, in a specified time period. A successful call is a call attempt to a valid number, properly dialed, where the called party's busy tone, ringing tone, or answer signal is recognized on the access line of the calling user.

Starting from 1999, operating systems have been developed with the aim of ensuring the offering of new services, optimizing operational activities and pursuing quality objectives. Procedures were developed for systems dedicated to supervising traffic for verifying levels, the immediate management of measurements and constant monitoring of the quality of the service provided. In systems that operate the flexible network for data transmission, features were added which reduce activation and connection time, permit the timely recognition of customers who have experienced malfunctions in service and augment the availability of the connections themselves. Moreover, operating systems have been equipped with new features for marketing new services.

In order to reduce costs and improve efficiency, in 2001 we started, and are continuing to implement, an extensive program to reengineer our network operation and maintenance organization, to permit more effective use of human resources.

Broadband Network/ADSL. Our broadband network is able to support advanced telecommunications services and multimedia applications; in order to achieve this objective we have installed a significant amount of fiber optic cables. In 1998, we began introducing ADSL systems over copper pairs to deliver interactive services (e.g., fast-Internet). ADSL allows us to fulfill market driven needs to provide services like fast-Internet, multimedia, video conferencing and teleworking either for business or residential customers. Furthermore, ADSL together with other existing infrastructure and satellite services allows us to focus the commercialization of our broadband network services on a market basis and to tailor investments to the growth of the market. In 2005, commercial services with access to ADSL technology for business customers and Internet Service Providers were extended to 3,800 cities (approximately 2,600 at the end of 2004). The commercial services for business customers include the use of ADSL technology in urban areas to supply access to IP and ATM services of our data networks. The services for ISPs supply ATM access based on ADSL technology to the public, leaving the commercial interface with the final customer to the service provider. At the end of 2005, the local exchange areas covered by ADSL technology numbered 4,501 (3,750 at the end of 2004).

Fiber optic Cables. At December 31, 2005, we had installed approximately 3.7 million kilometers of optical fiber for access and transfers, of which approximately 1.2 million kilometers were installed on long distance fixed-lines. Fiber optic cables significantly increase the capacity of the network and enable us to provide new advanced services based on the simultaneous transmission of several kinds of signals, such as voice, data and video. To enable the offer of such services, we are planning to introduce fiber optics in our local access network.

In 2005, we continued with the installation of cable containing 96 optical fibers on two backbones covering over 6,000 kilometers pursuant to a project which started in the second half of 2000, with the goal of creating an optical fiber ring between Milan and Palermo (T-Bone).

VoIP (Voice over IP) services. The full digitalization of our network completed in the backbone and metropolitan area networks and extended to the distribution networks supports an easier introduction of VoIP services. This is already available to business customers and is available to residential customers who opt for ADSL connectivity. We consider VoIP as an additional service whose value proposition to the customer includes additional telephone lines, numbers and handsets. Moreover by exploiting the additional features, such as presence and community, that can be provided funneling VoIP when associated to always-on connection, additional revenues can be expected. At the same time the additional value perceived by the customers contributes to the uptake and expansion of Broadband contributing to synergies associated with the broadband strategies.

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IPTV (Internet Protocol TV). We believe in the additional customer value provided by a quadruple play offer, making the user environment flexible to provide the services required in the most effective and seamless way for the user.

IPTV is an integral part of this drive. Experiments have been carried out during 2004-2005, first within Innovation and Engineering Services in Turin and then in four cities in Italy. The service (whose name is Alice Home TV) is now commercially available in major urban areas. IPTV is viewed as part of the grander scheme of making it possible for all our customers to access information in any form from any place, using fixed and mobile infrastructures as the situation requires.

Flexible Data Network. We also operate a flexible network equipped with a centralized system that makes it possible to establish dedicated data links from a work station. At December 31, 2005, approximately 382,000 direct digital line access points and approximately 90,000 direct analog line access points had been installed.

International Network

Since 1997, we have rationalized our international fixed network and enhanced our international transmission capacity.

We offer international wholesale services (Voice, Data and IP) and international retail services (Global Corporate Network) for multinational customers utilizing our own cross-border backbone, bilateral links and NNIA (Network Node Interface Agreements).

The cross-border backbone is based on three regional networks in Europe (PEB), Latin America (LAN) and in the Mediterranean basin (MED):

- **PEB** (Pan European Backbone). A fiber optic network 2 fiber pairs, 400 Gbit/s each laid in the main industrialized European countries: Italy, France, U.K., Belgium, Germany, Switzerland, Austria and Spain with a total length of 12,000 km. The cross-border services available for wholesale customers are: Managed Bandwidth, IP Connectivity, International Private Leased Circuit, Global Voice Services, GRX (GPRS Roaming eXchange for Mobile Operator);
- **LAN** (Latin American Nautilus). A high capacity backbone based on an optical fiber ring network both on the earth and under the sea, with a total length of 30,000 km, including the Miami-New York City link. The ring, having optical automatic traffic protection and a bandwidth up to 320 Gbits, links the most important cities of South America to Central and North America;
- **MED** (Mediterranean Nautilus). A submarine optical ring, in a high-availability network configuration, with a total length of 7,000 km 6 fiber pairs, 64 lambdas (10 Gbit/s each) per fiber pair linking the main markets of the Central-Eastern Mediterranean area: Italy, Greece, Turkey and Israel. Presently, the optical ring links Catania, Athens, Chania-Crete, Haifa and Tel Aviv.

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We connect, with our international network, more than 350 world-wide operators and owns capacity on more than 434,500 kilometers of submarine cables that, from Italy, transport traffic along two major paths: East/West routes (towards the United States, Middle and Far East) and North/South routes (toward Central and Northern Europe).

The multiservice network is based on class-4 soft-switches, IP/MPLS and ATM switching devices, and state of the art transmission technologies: DWDM and SDH (10 Gbit/s lambda, where lambda represents an optical wavelength) with traffic protection mechanisms (MS SPRING, SNCP and MSP).

Our international backbone has been built to offer end-to-end services in strategic areas; it has POPs in Europe (18 POPs), in the USA (4 POPs), in the Mediterranean basin (5 POPs), in South America (9 POPs) and in Asia (1 POP).

The POPs in the USA belong to Telecom Italia Sparkle of North America (TISNA), a wholly-owned subsidiary of Telecom Italia, that has implemented POPs in Newark (NJ), New York (NY), Miami (FL) and Ashburn (GA) to offer Voice and IP/Data services with a network connected to the Pan European Backbone and to Latin American Nautilus.

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The multiservice backbone delivers voice, IP and managed bandwidth services in the USA and Europe, IP and managed bandwidth services in South America and managed bandwidth services in the Mediterranean.

During 2005, major projects were related to:

- development of new features and capacity upgrade of the switching devices for the international voice services;
- upgrade of the transmission capacity of the Pan European and transatlantic backbone; and
- new POP in Warsaw dedicated to retail services for Multinational Customers.

In November 2005, the new submarine cable system South East Asia Middle East Western Europe 4 (SEA-ME-WE 4) came into service. This submarine cable system was developed by a consortium of 16 international telecom operators including the Telecom Italia Group. The system spans some 20,000 km across the world with an ultimate capacity of 1,300 Gbit/s, terminating in 15 countries including Singapore, Malaysia, Thailand, Bangladesh, India, Sri Lanka, Pakistan, United Arab Emirates, Saudi Arabia, Egypt, Italy, Tunisia, Algeria and France. The SEA-ME-WE 4 cable system is the fourth in the series of the SEA-ME-WE cable systems.

In November 2005 we acquired the European network of Tiscali International Network S.A.S., that spans approximately 11,500 Km through the United Kingdom, The Netherlands, Belgium, France, Spain, Germany, Austria, Czech Republic, Poland and Italy and includes 7 metropolitan rings in London, Paris, Brussels, Amsterdam, Marseille, Madrid and Zurich. The network completes the PEB and extends the coverage and the presence in the Eastern European region, increasing the whole network reliability and availability because of route and network providers' diversity.

In November 2005, the replacement of the legacy switching exchanges in Italy with a new platform based on class-4 soft-switches according to NGN architecture (Next Generation Network) and IMS model (IP Multimedia Subsystem) was completed. Since February, 2004 more than 200 international carriers have been involved in the migration of more than 200,000 circuits from the old to the new platform. The new platform increases the flexibility, volume and speed of routing and re-routing plans, with an unprecedented level of service quality. Today the soft-switch Voice Platform manages approximately 300,000 circuits and is connected to approximately 400 carriers. Moreover, the soft-switch technology allows the implementation of new services in a timely and efficient manner. We are the first European carrier to reach the all IP-based level on its international voice traffic network.

European Broadband Project

With the European Broadband Project, we have created an innovative offer of broadband access and services in a number of large metropolitan areas in Europe. The plan, started in 2003, currently includes France, Germany and The Netherlands through the

controlled companies Telecom Italia France, HanseNet and BBNED.

France

In 2005, Telecom Italia France increased the customers portfolio and the coverage of broadband service on LLU with the acquisition of Liberty Surf Group. In September 2005, a new integrated offer (VoIP) was started. In December 2005, a further extension of the LLU coverage in the area of the Ile de France (Paris), started, providing 100 new areas serviced by exchanges in early 2006.

Other main activities carried out during 2005 included:

- Activation of ADSL with new profile (2-5-8) Mbit/s;
- Rosso Alice Gateway;
- Activation of ADSL Wholesale with integrated profile (Voice and BB) at 10 Mbit/s and up to 20 Mbit/s for LLU customers; and
- Introduction of IPTV platform.

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Germany

In 2005, the project German Extension was initiated, which provides for the extension of the broadband services beyond the Hamburg area (including Lubeck), to other major cities in Germany.

The project comprises two phases:

- phase 1: extension of LLU coverage in 4 cities (Frankfurt, Berlin, Munich, Stuttgart), with a total of 250 new areas served by exchanges;
- phase 2: extension of LLU coverage in 10 more cities (Lüneburg, Lübeck, Offenbach am Main, Rostock, Karlsruhe, Solingen, Wuppertal, Essen, Oberhausen and Dortmund), with a total of 140 new areas served by exchanges.

At the end of 2005, the LLU coverage comprised 493 areas serviced by exchanges.

The main activities carried out during 2005 included:

- speed upgrade;
- new offer for small business customers;
- ADSL Wholesale Service (Alice 2000); and
- ADSL 2+ Service in Hamburg; Lubek and Rostok areas.

The Netherlands

BBNED's main achievements in 2005 relate to the activation of the IMSS/MSEM platform which became operational for the direct management of VoIP services.

V MAJOR 2005 CORPORATE EVENTS

- Under the program to reorganize the Information Technology Group, effective January 1, 2005, the following activities were transferred to the Wireline Business Unit:

the development and operation of the applications of the OSS (Operational Support System) and BSS (Business Support System) systems; and

the development, design, delivery and management of VAS for the Wireline market.

- Under the strategy to rationalize the operations of international wholesale, Telecom Italia Sparkle acquired:

in June 2005, the entire stake (100%) held by Telecom Italia in Latin American Nautilus S.A.;

in December 2005, the stakes held by Telecom Italia and Telecom Italia International in Mediterranean Nautilus S.A. (100%) and in MED-1 Submarine Cables Ltd. (99.91%).

- In November 2005, Liberty Surf Group S.A. acquired the entire stake (100%) of Telecom Italia France S.A. held by Telecom Italia Sparkle S.p.A..
- In November 2005, after approval by the Antitrust Authority, the agreement reached on August 2, 2005 between Telecom Italia Sparkle and Tiscali was executed for the purchase of Tiscali's fiber optic network owned by Tiscali International Network SAS (TINet SAS), for an equivalent amount of 8 million. Tiscali International Network SAS owns 11,500 km of optical fiber which cross 12 European countries. The transaction does not include the sale of the IP and VoIP international and national networks which, instead, are controlled by Tiscali International Network B.V..
- In November 2005, Liberty Surf Group S.A. purchased the entire interest held by Telecom Italia Sparkle S.p.A. in Telecom Italia France S.A..

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The Mobile Business Unit operates in the sector of national and international mobile telecommunications. Its international presence is concentrated in Latin America (in particular in Brazil).

The Mobile Business Unit accounted for gross revenues of 12,963 million in 2005 and 11,712 million in 2004.

As of December 31, 2005, the Business Unit was organized as follows:

Italy	MOBILE	Brazil
Tim Italia S.p.A. (1) (Mobile Italy)	TIM Brasil Group (Mobile Brazil) <ul style="list-style-type: none"> • TIM Participações Group <ul style="list-style-type: none"> TIM Nordeste Telecomunicações S.A. TIM Sul S.A. • TIM Celular S.A. <ul style="list-style-type: none"> Maxitel S.A. CRC Centro de relacionamento com clientes Ltda Blah! S.A. 	

(1) With regard to the Telecom Italia/TIM merger, on February 24, 2005, TIM S.p.A. proceeded to spin off the corporate operations relating to the domestic mobile telecommunications business to Tim Italia S.p.A.. The spin-off allowed Tim Italia to succeed TIM in the ownership of licenses and authorizations held by TIM for providing mobile communications services in Italy, as well as in all the user rights (even those temporarily assigned to TIM on the date of the contribution of the corporate operations), in the numbering and/or radio frequencies already under concession, license, general authorization, and the special authorizations ensuing from statements constituting declarations of the start of activities. On March 1, 2006, Tim Italia was merged into Telecom Italia.

Among the large mobile telecommunications operators in Europe at the end of 2005 Mobile Italy had the largest number of lines in its domestic market (source: Mobile Communication magazine) and has been the fastest growing area of the Telecom Italia Group's business for many years. Line growth was 3% in 2003, 1% in 2004 and 9% in 2005. Gross revenues were 10,076 million, 9,923 million in 2005 and 2004, respectively.

V **MOBILE ITALY**

- ***Services in Italy***

Mobile Italy offers digital mobile services as well as its legacy analog service which service ended on December 31, 2005. The GSM digital service, which commenced operations in April 1995, uses digital technology and is the standard throughout Europe. GSM generally provides higher quality transmission than analog service and may be used by customers to make and receive mobile calls throughout Europe and certain other countries. During 2005, Mobile Italy offered its whole third generation services (based on UMTS technology) and the advanced second generation services through the EDGE technology. These technologies are interoperable and permit seamless usage of dual mode handsets linked to UMTS and GSM/EDGE networks. As of December 31, 2005, roaming agreements have been reached with 446 operators in over 193 countries, allowing customers to make and receive calls abroad. See 4.2.2 Mobile Mobile Tariffs below.

- ***Customers and Lines in Italy***

The penetration of mobile telecommunications service in Italy is above the Western European average at approximately 123.5 lines per 100 inhabitants at the end of 2005 compares to a penetration rate of 109 lines per 100 inhabitants at the end of 2004. Growth rates have been substantially higher than the European average. The increase is due to innovative services and an increase in customers with multiple lines and the number of operators. The customer base consists of GSM subscribers and customers holding GSM/UMTS TIM Cards (**GSM/UMTS Prepaid Customers**). In 2005, we had a 29% market share of net additional GSM and UMTS lines, corresponding to 2.4 million net lines, compared to 1.6 million for Vodafone Omnitel, 1.6 million for Wind and the remaining 2.8 million attributable to H3G(3).

It should be noted that Mobile Italy's subscriber numbers do not include 422,000 silent lines. Silent lines are prepaid lines which are no longer active but have not yet been disconnected. As the Italian market is characterized by a high penetration of prepaid cards, customers will acquire multiple lines to take advantage of special commercial offers but with the intention of not maintaining the lines once the offer expires. We exclude these lines in order to ensure greater consistency between the number of lines managed and business development.

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At December 31, 2005, the number of lines for our GSM and UMTS mobile service was approximately 28.5 million (of which 26.3 million were GSM lines and 2.2 million were UMTS lines), consisting of 3.2 million GSM subscribers and 25.3 million of prepaid lines, (of which 23.1 million are GSM lines and 2.2 million are UMTS lines). At December 31, 2005 we had 94,000 TACS subscribers and prepaid lines.

The table below sets forth, for the periods indicated, geographic and population coverage data for GSM services.

	<u>Year ended December 31,</u>		
	<u>2003</u>	<u>2004</u>	<u>2005</u>
GSM Telecom Italia Italian geographic coverage	94	94	95
GSM Telecom Italia Italian population coverage	100	100	100

The table below sets forth, for the periods indicated, selected customer data for our Italian mobile business.

	<u>Year ended December 31,</u>		
	<u>2003</u>	<u>2004</u>	<u>2005</u>
	(number of customers in thousands)		
Lines at period end(1)	26,076	26,259	28,576
GSM subscribers(2)	2,595	2,809	3,186
GSM/UMTS Prepaid Lines	22,906	23,226	25,296
	(in %)		
Customer growth	3.1	0.7	8.8
Churn(3)	13.2	13.2	16.9
Mobile Italy penetration(4)	45.3	45.5	49.1
Cellular market penetration(5)	99.2	109.0	123.5
	(in euro)		
Average revenue per line per month(6)	29.1	29.9	29.3

(1) Includes Prepaid Customers and excludes the silent lines. Also includes, 95,000, 52,000 and 25,000 TACS subscribers as of December 31, 2003, 2004 and 2005, respectively, while TACS prepaid lines were 480,000, 172,000 and 69,000 as of December 31, 2003, 2004 and 2005, respectively.

(2) Commenced GSM services in April 1995.

(3) Data refers to total lines. The churn rate for any given period represents the number of domestic Mobile customers whose service was discontinued during that period due to a payment default or who voluntarily gave up a mobile telephony service during that period, expressed as a percentage of the average number calculated on an annual bases of customers during that period.

- (4) Domestic Mobile customers per 100 inhabitants.
- (5) Customers per 100 inhabitants for the entire market.
- (6) Including Prepaid Card revenues, non-Domestic Mobile customer traffic revenues and excluding equipment sales.

The growth in mobile lines over the three year period reflected in the table above has resulted almost entirely from the marketing success of the GSM/UMTS TIM Card, a prepaid card which permits the customer to make outgoing calls up to the limit on the card for the 12 months following issuance of the card or the last recharge of the card and receive an unlimited number of calls for the 13 months following issuance of the card or the last recharge of the card. If a GSM/UMTS TIM Card is not recharged within this 12-month period, the customer will not be able to make outgoing calls but for one additional month such customer will be able to receive incoming calls. The GSM/UMTS TIM Card can be recharged at any time to permit additional outgoing calls. The GSM/UMTS TIM Card offers several advantages, including elimination of bad debt charges and lower administration costs, as no statements are sent to customers. Approximately 88.8% of Mobile Italy's lines at December 31, 2005, are prepaid.

- ***UMTS License in Italy***

The Italian government awarded five UMTS (third generation mobile communication system) licenses in Italy in November 2000. TIM, together with Omnitel S.p.A. (now Vodafone Omnitel N.V.), WIND S.p.A., and Andala S.p.A.

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(now H3G S.p.A.) and IPSE S.p.A., were awarded licenses to provide third-generation mobile services. TIM committed to pay 2,417 million for its license, with approximately 117 million, 117 million, 117 million and 2,066 million having been paid in December 2003, November 2002, November 2001 and December 2000, respectively. The licenses are valid for 20 years starting from January 1, 2002. During 2005, we carried out a wide development of our third generation services and, consequently, experienced a significant increase of the customer base. UMTS users lines, rose, as at December 31, 2005, to approximately 2.2 million.

- **Traffic in Italy**

The table below sets forth, for the periods indicated, selected traffic data for our Italian mobile business.

	Year ended December 31,		
	2003	2004	2005
	(millions of minutes)		
Total outgoing traffic per month	2,090	2,211	2,314
Total incoming and outgoing traffic per month	3,202(1)	3,435(2)	3,550(3)

(1) Includes domestic mobile incoming and outgoing traffic (95.5% of total mobile traffic), international traffic (1.9%) and roaming traffic (2.6%). Data includes fixed outgoing traffic to the mobile network.

(2) Includes domestic mobile incoming and outgoing traffic (93.8% of total mobile traffic), international traffic (2.2%) and roaming traffic (4.0%). Data includes fixed outgoing traffic to the mobile network.

(3) Includes domestic mobile incoming and outgoing traffic (92.2% of total mobile traffic), international traffic (2.6%) and roaming traffic (5.2%). Data includes fixed outgoing traffic to the mobile network.

- **Mobile Tariffs in Italy**

Mobile Italy customers (other than Prepaid Customers) are charged a one-time connection fee, a monthly basic charge and traffic fees for calls, as well as a monthly government tax. Prepaid Customers are charged an initial connection fee of 20 for the GSM/UMTS TIM Card and TACS prepaid service and are required to pay a fee ranging from 5 to 1 to the dealer for each recharge, according to the cost of each recharge. No other connection or subscription fees or taxes are payable by Prepaid Customers. Mobile customers (including Prepaid Customers) must purchase their own mobile telephone handsets. In 2005, approximately 69% of Mobile Italy revenues services were derived from traffic charges (net of access charge), 7% from sales and rental of equipment, 14% from VAS and 10% were miscellaneous revenues (subscription and connection fees).

We offer our customers a variety of tariff packages which are tailored to address different usage patterns and market segments (Consumer, SOHO, SME, Enterprise). Such packages include offerings to our GSM customers of free minutes packages which are available in various options. We also offer packages such as TIM Menù, a dedicated TACS and GSM prepaid card. The customer can choose a rate suited to his or her own needs, combining the various items on a menu. The objective is to simplify the service offer and at the same time make it more flexible.

We enhanced our voice and VAS services during 2005 in order to stimulate usage and traffic among Mobile Italy customers and increase customer loyalty. Some of the new services and offers were:

- 7 su 7 package: this package, available to subscribers and designed for professionals and small businesses, allows customers to make calls on week days for a single charge of 0.07 per minute (exclusive of VAT) to all fixed and mobile numbers. On weekends, customers making calls are only charged the answering charge. In addition, for an additional 7 a month, users can purchase a wide range of UMTS telephones in up to 24 monthly installments, and make free calls and videocalls to internal numbers belonging to the same enterprise or group that subscribe to the contract.
- Uno per tutti package: launched in June 2005, this package enables users to send texts and speak, at a charge of 0.01 per minute to any other Mobile Italy customer. The service may also be used with international roaming and makes it possible not only to make calls, but to receive calls at a charge of 0.01 per minute on all the FreeMove and roaming partner networks in 37 countries, in Europe and the Americas.

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- **TIM Tribù** : at the end of September 2005, we launched an offer to prepaid customers that combines low rates (0.01 per minute for calls and SMS towards customers that belong to the phone community) with the opportunity of using a virtual space on the web and on the 10-megabyte TIM mobile portal where blogs can be created to communicate using cell phones.
- **Mobile Office**: we offer a wide range of Mobile Office solutions. From dual-mode PC Card (EDGE/UMTS) to a variety of Smartphone and PDA for mobile access to e-mail and web services. It is possible to buy all devices bundled with tailored tariff data plans in order to satisfy all the customers' needs.
- **Unica New** : this new tariff plan is very easy and simple to use, because it allows customers to call any number (fixed or mobile) at the same price of 0.19 per minute for all national calls directed to fixed or mobile numbers.
- Since December 2005, the offer **1 Per Tutti all'estero** (launched as part of the summer campaign 2005) has been replaced with a new stable tariff option called **TIM Globe** which provides a flat and very low rate both for originated and received calls (0.16 per minute VAT excluded) and a call set up fee that varies depending from which **Roaming Zone** the call is originated or received (within the EU countries the set-up fee varies from 0.83 to 1.67 for originated calls and is 0.83 for MTCs VAT excluded). One of the main characteristics of this option is that the discounted tariffs are network independent so that the customer does not need to pay attention to which mobile network the handset is connected to. This option is valid in more than 70 countries (covering all Europe and countries in North and South America, Africa and Asia that are most significant for Italian travelers).
- **TIM Famiglia** : a new tariff plan available to all GSM prepaid customers that provides good value for money (0.01 per minute, plus 0.16 set-up fee) for every call and videocall directed to two Mobile Italy numbers and one fixed number.
- **TIM Welcome Home** is a new tariff plan for all GSM prepaid customers and oriented to the immigrant segment with a favorable rate for international calls to some countries and Mobile Italy customers who subscribe to the same tariff plan. National calls tariff is 0.06 per minute towards the community plus 0.16 set-up fee.
- **Z-SIM** : in December 2005 Mobile Italy launched the first SIM Card that allows mobile phones to communicate with TV set-top boxes, computers, household appliances and a host of home electronics devices.

The new SIM Card, which is a Telecom Italia Group world exclusive, will be rolled out in 2006. The SIM card incorporates cutting-edge radio technology that enables all TIM cellphones to communicate with any terminal or device equipped with a similar SIM card simply by pressing a key on the phone. The technology works both inside and outside the home.

The new SIM card protects users from intrusions and tampering to ensure transaction security. The new security application uses combined with the SIM card's built-in authentication and identification technologies, including a PIN number known only to the user. In consequence, Mobile Italy is able to offer its customers a secure and efficient payment solution.

We also offer innovative services, such as an offering called AutoRicarica. The AutoRicarica formula, whereby Mobile Italy gives a bonus of 3.70 (VAT included) for each 100 minutes of calls received, has proven to be particularly successful.

We also offer certain discount packages, which include TopTIM, a discount plan for professionals that rewards both length of subscription and volume of traffic, and TIMClub, a 15% discount on the three most frequently called wireless numbers (which is only available after the free bonus minutes have been used).

- ***Value Added Services in Italy***

Mobile Italy has been building its brand as a platform for content providers by entering into partnerships and developing business synergies.

In order to offer a wider range of services and content to its customers, we have strengthened our partnerships with some important providers like Acotel, Zed, Buongiorno Vitaminic and brands like Disney, MTV and Mediaset.

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Business Units

We also have agreements with leading Italian banks and financial institutions to provide on-line trading and mobile banking and we were the first operator to launch the MSS Mobile Banking service in 2003.

Since 2000, when Mobile Italy started GPRS services, we have launched EDGE services and extended our UMTS coverage. EDGE makes the use of multimedia services more satisfactory for our customers both in relation to consumer market applications, such as the MMS or video streaming, and the more typical corporate applications such as e-mail management, Internet and Intranet navigation due to its ability to transmit data more rapidly.

We were the first in Europe to introduce the PhotoMessage service (TIM Click), and in 2003 we enriched our multimedia portfolio by offering Java games (including Multiplayer) and Video.

In October 2003, we were the first mobile operator to launch mobile TV. The services contents are available pursuant to agreements between Mobile Italy and major TV channels.

In April 2004, we launched *Programma per le aziende*, an offering addressed to our business customers, aimed to increase both revenues and penetration of mobile services such as browsing and e-mail management. The *Programma per le aziende* allows business customers to upgrade the PC Cards they already own to 3G technology: UMTS (launched in June, 2004), EDGE (launched in September 2004), and dual EDGE/UMTS.

In order to strengthen our strategy on multimedia content we launched in July 2005 our UMTS Mobile Portal in addition to the GPRS and in the same period, the new Mobile TV that offer special format built just for the mobile customer. The TIM Mobile Portal became in this way a multimedia store for digital music, format TV, football and cinema.

- ***Billing in Italy***

Mobile Italy's customers (other than Prepaid Customers) are billed in a staggered bimonthly billing cycle. We endeavor to minimize bad debts by implementing a credit check on each customer at the time of sign-up and by requiring certain customers to post a security deposit. In addition, if payment is not received, the customer is notified accordingly and his or her ability to place outgoing calls is interrupted. If no payment is received, all services are terminated.

- ***Marketing and Distribution in Italy***

We believe that our active marketing programs, extensive customer service and distribution network (primarily a nationwide network of independent dealers) and responsiveness to customer needs provide us with a significant competitive advantage. At December 31, 2005, there were 1,560 distribution partners, with 4,230 sales points (including 59 Telecom Italia Group outlets marketing our mobile products and 23 shops directly owned by Telecom Italia). As of December 31, 2005, Mobile Italy employees

(about 54% of its total workforce) were involved in customer service activities. We have adopted a multi-channel approach for our customers: large companies are served with a direct sales channel that is able to implement complex and customized solutions. SME and SOHO business customers are supported by indirect sales channel (external agents) as well as a pull channel (franchisee, own shops and dealers). In terms of offering, we also enhanced and customized the offers for our business customer base (e.g. proposing FreeMove offers to MNCs or dedicated offers to SME) in order to match customers needs (voice and value added services).

- ***Cellular Network in Italy***

Our GSM/EDGE network consists of approximately 13,740 radio base stations and 714,500 radio channels (an increase of 4.6% over 2004). We have continued the UMTS network planning and implementation, extending coverage to all regional large towns, as per 3G license requirements, and to many additional clients and areas of interest. Our UMTS network consists of about 6,380 radio base stations and 246,200 radio channels (an increase of 86.8% over 2004). Mobile Italy has continued to reduce the TACS (analogue) network capacity. At the end of 2005 the TACS network consisted of approximately 2,580 radio base stations and 26,850 radio channels. The TACS network was switched off at the end of 2005.

Table of Contents**Item 4. Information On The Telecom Italia Group****Business Units****V MOBILE BRAZIL**

TIM Brasil (an indirect wholly owned subsidiary of Telecom Italia) controls TIM Participações group and a number of other subsidiaries, of which TIM Celular and Maxitel own licenses to provide mobile services in different parts of Brazil. Since 2001, Telecom Italia has taken a number of steps to simplify and consolidate its mobile operations in Brazil.

TIM Brasil gross revenues were 2,900 million in 2005 compared to 1,798 million in 2004, an increase of 1,102 million, or 61.3%. The increase was due to growth in the customer base, the contribution made by value-added services (which rose from 3.2% of revenues in 2004 to 5% in 2005) and revenues from voice traffic.

The TIM Brasil group, the sole operator to have nationwide coverage, is the market leader in the GSM market with 16.6 million lines at December 31, 2005 (an increase of 88.7% compared to December 31, 2004). Total lines at December 31, 2005 were 20.2 million of which more than 82.3% use GSM technology. This was an increase of 6.6 million lines since the beginning of the year (an increase of 48.4%). The TIM Brasil group, with a market share of 23.4%, ranks second nationally in terms of the number of customers.

Operating loss in 2005 was 190 million compared to 129 million in 2004, an increase of 61 million. This result was achieved notwithstanding the increase in depreciation and amortization mainly related to the investments for the development of network infrastructures and information systems.

V OTHER INVESTMENTS***Turkey***

Avea offers mobile telephone services using GSM technology on Turkish territory and is the third largest mobile network covering 75.6% of the population.

At December 31, 2005, Avea had more than 6.1 million customers, an increase of 1.3 million lines compared to December 31, 2004; the market share is about 14%.

Actions by the company during the year were principally directed to the business segments (Corporate and SME) and students. In the business segment, Avea revised its flat-rate plans in order to meet the needs of a broader segment of companies; it also introduced the Blackberry service.

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In the student segment, Avea launched a series of innovative promotions based upon the concept of community featuring competitively-priced calls and SMSs and the introduction of new services.

4.2.3 MEDIA

The Media Business Unit (the name taken after the sale of the Internet activities described below), operates in the following segments:

- Television: with La7 and MTV, in the production and broadcasting of editorial content through the television transmission networks entrusted under concession and in the marketing of advertising space in the TV programming. It also operates as a television broadcasting network operator in analog and digital technology. Furthermore, the Business Unit manages satellite channels and pay-per-view services using digital terrestrial television;
- News: with TM News, a national agency operating on a 24-hour basis. It operates on market under the APCom brand.

As of December 31, 2005, the Business Unit was organized as follows:

MEDIA	
TV	News
La7	TM News
MTV	
TI Media Broadcasting	

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Business Units

V TELEVISION

Telecom Italia Media provides television services through Holding Media e Comunicazione S.p.A. which holds the broadcasting licenses for La7 and MTV Italia.

La7 provides news information on a 24-hour basis, and is currently cooperating with the Internet Services business segment to provide on-line news information through the use of video-streaming technology. La7 has been broadcasting under an all-news format since March, 2002.

MTV Italia is a television channel providing music programs on a 24-hour basis. The MTV brand is a well known in the music industry and in the television network business.

On April 29, 2005, La7 signed an agreement with Elefante TV S.p.A. to acquire Elefante TV's national TV broadcast unit for 115.5 million. Elefante TV holds a private television broadcasting concession for terrestrial frequencies over the national territory and an authorization for digital broadcasting. On the same date, La7 signed an agreement to purchase radio and television facilities and frequencies from local concession holder Delta TV, which operates in Central and Southern Italy, for 12 million plus accessories charges amounting to 1 million.

Overall, the broadcasting frequencies included in these agreements now provides Telecom Italia Media with coverage to reach approximately 70% of the Italian population and will allow expansion to both its analog and digital television product offerings.

The offering of digital terrestrial broadcasting includes the TIM First Division football team matches (Ascoli, Cagliari, Chievo, Empoli, Fiorentina, Lecce, Palermo, Parma and Reggina). Access to the digital terrestrial television service was launched on January 22, 2005. Customers have to purchase a rechargeable smart card with which they can access pay-per-view events without the need for a subscription. As of December 31, 2005, more than 884,000 smart cards had been distributed (approximately 925,000 at February 14, 2006) and approximately 1,300,000 events have been sold. In the June 2005-September 2005 period, the pay-per-view offering was enriched with the broadcasting of approximately 15 auteur movies, high-level international boxing matches and music concerts, as well as many interactive applications (such as Guida TV, Ultima ora, etc.).

In August 2005, La7 Sport, the first free Digital Terrestrial channel entirely dedicated to sports information, began broadcasting. The new network will provide full coverage of the world of sports from soccer to boxing, cycling, racing, athletics, tennis, basketball, fencing, sailboat racing and other sports.

La7 and MTV also continued experimenting with new services related to digital terrestrial television.

v **News**

TM News is a national news agency operating on a 24-hour basis. It operates under the APCom brand. The main Rome office is supported by the editorial office in Milan and correspondent offices in Brussels, Budapest and New York. The editorial staff consists of around 70 journalists focusing on domestic political issues, the economy, national, European and global financial markets, news and international politics. Its position is strong with regard to international coverage and quality (editorial standing) and quantity (average daily production of more than 800 news items) of its journalistic production. The company has an exclusive license for the distribution of Associated Press news in Italian. Its customers are major daily newspapers, the editorial department of a major national television broadcaster and top private and public companies and institutions.

The agency's portfolio of services has been extended with the launch of the News Bulletin (Nuova Europa) covering central and eastern European countries. The average daily production of news in 2005 has risen significantly compared to the previous year (an increase of 23%).

4.2.4 OLIVETTI

The Olivetti Business Unit (which changed its name on April 5, 2005 from Olivetti Tecnost to Olivetti) operates through the Office Products Division in the sector of ink-jet products for the office, digital printing systems and the development and production of products associated with silicon technology (ink-jet print-heads and MEMS).

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Through the Gaming & Service Automation and Specialized Printers Division (formerly the Systems Division), the Business Unit provides specialized applications for the banking field and commerce and information systems for gaming and lottery operation and management. In addition, through Wirelab S.p.A. the Business Unit operates in fixed phone repair.

The principal markets of the Business Unit are Europe and Asia.

As of December 31, 2005, the Olivetti Business Unit included the following companies:

OLIVETTI

Olivetti S.p.A.(1)

- Olivetti I-Jet S.p.A.

- Wirelab S.p.A.(2)

- Olivetti International B.V.

(foreign sales companies)

(1) On April 5, 2005 Olivetti Tecnost S.p.A. was renamed Olivetti S.p.A..

(2) On February 28, 2006, the sale of 60% of the subsidiary Wirelab S.p.A. from Olivetti S.p.A. to the partner Urmet S.p.A. was executed; after this operation Wirelab S.p.A. is owned 90% by Urmet S.p.A. and 10% by Olivetti S.p.A. As of December 31, 2005 Wirelab S.p.A. had 46 employees.

In December 2005, a new organizational structure for the Olivetti Business Unit was approved: such structure operates (without divisions) through the Business & Market Development business segment (responsible for all the marketing and sales activities) and the Product/Technology Development & Industrial Operations business segment (responsible for manufacturing, research and logistics of the whole of Olivetti Business Unit).

In 2005, the Office Products Division successfully developed and introduced new ink-jet technology products. Olivetti launched a new range of products, color ink-jet multifunctional devices and portable ink-jet photographic printers, which offer both a contemporary design and a friendly user interface for ease of use. With this new offer, Olivetti entered a fast-growing market and enhanced visibility of its brand in the main European countries. The products were launched in August 2005 in the Italian market, with the introduction of these new products in the mass market distribution chains coupled with an advertising campaign in major media. In the last quarter of 2005 the products were introduced in the main European markets. Over 45,000 units were sold during 2005.

Revenues from the Office Products Division were 256 million in 2005 and 308 million in 2004 (a decrease of 52 million or 16.9%); such decrease was due to the rationalization of the current products offering, reduction of the average price and quantities of fax machines (compared to the previous year, in particular, sales to OEM customers decreased; they covered only in the fourth quarter) and lower demand for ink-jet supplies.

In 2005, the performance of the Office Products Division was negative due to the R&D and commercial investments of the new ink-jet products and lower sales of ink-jet supplies.

V GAMING AND SERVICE AUTOMATION & SPECIALIZED PRINTERS PRODUCTS (FORMERLY SYSTEMS DIVISION)

The main activities of the Gaming and Service Automation business in 2005 included the definition and management of contractual agreements with the Lottomatica Group for the supply of approximately 34,000 terminals for automated gaming (for a total amount of approximately 63 million for products and related services) and for the supply of 35,000 terminals for the operation and printing of revenue stamped paper (for a total amount of approximately 8 million for products and related services).

Despite the significant results in the Italian market, revenues from the Gaming and Service Automation business were 62 million in 2005, a decrease of 9 million, or 12.7% compared to 71 million in 2004; such decrease was mainly due to a significant reduction in foreign markets activities (in particular, an important contract was signed and completed during 2004 for the supply of approximately 25,000 terminals for an electronic voting system in Venezuela).

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Business Units

Revenues from the Specialized Printers Products business were 95 million in 2005, a decrease of 14 million, or 12.8% compared to 109 million in 2004.

In the Banking sector of the Specialized Printers Products business, lower sales of specialized printers in Western countries were the result of a reduction in prices, while a substantial stability in volumes in Asian markets was achieved despite the strong competition from a growing number of vendors in this sector.

In the Retail sector of the Specialized Printers Products business, there was a reduction both in terms of volumes and profitability of PR4 specialized printers in 2005, while sales volumes of cash registers in the Italian market were stable, also due to the introduction of new models.

V NUOVE INIZIATIVE INDUSTRIALI

In 2005 revenues from Wirelab S.p.A. (repair and regeneration of telephone exchanges), were in line with 2004 improving the operating income.

4.2.5 OTHER TELECOM ITALIA GROUP ACTIVITIES

The Other Activities of the Telecom Italia Group consist of the Central Functions (Group Functions and Services Units) and starting from January 1, 2005, the foreign activities which are not included in other Business Units (the consolidated subsidiary Entel Bolivia Group, the affiliates Telecom Argentina Group, Brasil Telecom and ETECSA).

V CENTRAL FUNCTIONS

Central Functions includes Group Functions and Service Units.

The Group Functions are responsible for ensuring coordination, direction and control at the Group level in their spheres of activities, whereas Service Units are responsible for ensuring the performance of common operating activities to support the business. Starting from January, 1, 2006, the former TILAB (now Innovation & Engineering Services) and Information activities were transferred to Operations. IT Governance is included in Group Functions.

Group Functions include the Staff Functions of Telecom Italia S.p.A. (Human Resources & Organization, Finance Administration & Control, Corporate & Legal Affairs, International Legal Affairs, Public & Economic Affairs, Merger & Acquisition, Investor Relations, International Affairs, General Counsel), Group Communication (which includes the Italia Project) and Communication and Image

Functions, Corporate Latin America and Telecom Italia International.

Service Units include the operational service activities performed for the Business Units/Central Functions/Companies of the Group.

V **INFORMATION TECHNOLOGY**

After the merger of IT Telecom and EPIClink in Telecom Italia at the end of 2004 and with the new organizational structure of the Group introduced on October 5, 2005, a new organizational model was devised which allocated the Information Technologies activities as follows:

- **Operations.** The activities relating to the development and operations of the applications of the systems OSS (Operational Support System) and BSS (Business Support System) and the development, design, delivery and management of VAS for the fixed telephony market have been transferred to Operations, with the aim being to integrate end-to-end processes so as to maximize the operational synergies between demand management and development activities.

This structure also includes the activities for the realization and operation of the IT Group infrastructures (Data Centers) for the purpose of taking better advantage of synergies and encouraging convergence processes. These activities, transferred during 2005 to IT Telecom S.r.l., were, on December 30, 2005, partly spun-off by IT Telecom S.r.l. and by Tim Italia to the newly formed company Telecom Italia Data Center S.r.l.. This latter company was merged into Telecom Italia on December 31, 2005. IT Telecom S.r.l. will retain the Certification Authority business.

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- **Central Functions.** The activities relating to the definition of the reference architectures used in the projects of the Business Units have been transferred to Telecom Italia's Corporate Function with the aim of making IT Group strategies more uniform.

V ENTEL BOLIVIA GROUP

Telecom Italia International holds, indirectly, a 50% stake in Entel Bolivia, the Bolivian national long distance and international telephony operator, which was acquired in 1995. Local regulations established that until November 2001, when liberalization of the market began, long distance telecommunications services would be provided by Entel Bolivia under a monopoly system. In 2001 complete deregulation of the telecommunication market took place, carrier selection was introduced and local access, previously in the exclusive hands of cooperatives, was liberalized.

As of December 31, 2005, Entel Bolivia had 1,447,000 mobile lines, an increase of 26.3% compared to December 31, 2004 (1,146,000 mobile lines) and 57,000 fixed lines subscribers, an increase of 14.0% compared to December 31, 2004 (50,000 fixed lines).

On July 19, 2005 a preliminary agreement was executed between International Communication Holding N.V. (ICH), a wholly owned subsidiary of Telecom Italia International N.V., and Cooperativa de Telecomunicaciones de Santa Cruz Cotas Ltda (Cotas) for the sale of International Communication Holding N.V.'s equity stake in Euro Telecom International N.V. (ETI) which holds a 50% stake in Entel Bolivia Group. On December 22, 2005 the agreement was terminated because certain conditions were not realized in the stated time.

On September 20, 2005, the Extraordinary Shareholder's Meeting of Entel Bolivia approved the capital reimbursement in the amount of BOB 3,202,247,000. ETI, an indirectly wholly owned subsidiary of Telecom Italia International N.V., received, on October 28, 2005, its share of the reimbursement equal to 162.9 million.

V TELECOM ARGENTINA GROUP

Telecom Italia and Telecom Italia International through Nortel Inversora/Sofora hold, indirectly, a 13.97% stake in the Telecom Argentina group.

The Telecom Argentina Group has a strong presence in Argentina in the telecommunications industry (Mobile, Wireline, Internet and Data) and is active in the mobile communications market in Paraguay.

At the end of 2005, it had 3,625,000 fixed lines, an increase of 4% compared to December 31, 2004 (3,484,000). The mobile customer base increased by 56.8% compared to 2004 reaching 6,800,000 customers (of which 9.6% are in Paraguay). The mobile penetration rate in Argentina reached 57%.

In 2005, the number of post-paid customers doubled compared with 2004 and represented 32.8% of the total mobile customer base (25.3% in 2004). During 2005, customers continued migration to GSM technology.

The process of debt restructuring, started in June 2004, was completed by the terms of the APE (Acuerdo Preventivo Extrajudicial) on August 31, 2005 and it was judicially declared complete on December 28, 2005. This restructuring involved the issue of new notes and the payment of a cash amount in exchange for the outstanding debt.

V BRASIL TELECOM GROUP

The company operates fixed telephone services in Region II (Paraná, Santa Catarina, Distrito Federal, Tocantins, Mato Grosso, Mato Grosso do Sul, Rondônia, Rio Grande do Sul, Acre and Goiás) covering about 2.8 million square kilometers (33% of the total area of the country), with a population estimated at approximately 43 million (23% of the total population) with three metropolitan areas of more than one million inhabitants including Brasilia, the capital of the nation.

Brasil Telecom has one of the largest telecommunications networks in Brazil with a broad offering of services for telecommunications, fixed telephony, broadband and narrow band, free internet, data transmission and mobile telephony launched at the end of 2004, using GSM technology.

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The fixed line customer base at December 31, 2005 reached 9,560,000, with an increase of 57,000 compared to December 2004. Broadband service increased sharply with 1,014,000 lines at the end of December 2005, representing an increase of more than 89% compared to December 2004.

The mobile business had 2,213,000 customers at December 31, 2005; an increase of 1,591,000 compared to December 2004 (622,000).

Brasil Telecom's market share of mobile telephony at December 31, 2005 was 8.7% of the total region.

On April 28, 2005, TIM Brasil, and Brasil Telecom reached an agreement to better exploit the synergies arising from the integration of fixed platforms with mobile platforms. The agreement, which envisaged a series of measures and approval by the competent Brazilian authorities, provided for:

- the merger, by incorporation, of Brasil Telecom Celular (BRTC), a wholly-owned subsidiary of Brasil Telecom operating in Region II (which includes nine States in South and Central-East Brazil), into TIM Brasil;
- the development of sales and marketing activities, combining the technological know-how, service offering and distribution networks of the two companies;
- the elimination and optimization of existing overlapping licenses and infrastructures of the two companies. In particular:
 - the relinquishment of TIM Brasil's long distance licenses and the utilization of the carrier services of Brasil Telecom;
 - the availability of Brasil Telecom's sites and infrastructures for use by TIM Brasil, accelerating the programs to expand coverage of the network.

This agreement also responded to the requests of the Brazilian National Regulatory Agency (ANATEL) to resolve the problems concerning the overlapping of the mobile and long-distance licenses of these two operators.

The implementation of the agreement between BRTC and TIM Brasil and of the merger provided therein were impeded as a result of legal challenges initiated by some of the indirect co-shareholders of BT on various proceedings and the merger agreement was terminated on April 29, 2006 in accordance with its terms. The relevant parties are continuing to seek a resolution to the overlap in licenses to comply with Anatel's determinations.

At the same time, an agreement was reached between Telecom Italia International, the other co-shareholders in Solpart (the entity through which Telecom Italia International's interest in Brasil Telecom is held), Techold and Timepart, as well as Solpart, Brasil Telecom Participações and Brasil Telecom, with respect to resuming the Telecom Italia Group's role as an industrial partner in Brasil Telecom following the ending of the disputes concerning the restoration of the exercise of its governance rights (temporarily suspended under the August 2002 contract). Therefore, by virtue of Telecom Italia International's exercise of its governance rights, beginning from the interim financial statements for the first half of 2005, the equity method used to account for the investment in Solpart, which had been suspended in 2002, was once again used to value the investment in Solpart in the consolidated financial statements of the Telecom Italia Group. The positive effect on the statement of operations amounts to 94 million and the total carrying amount of the investment is 214 million.

On September 30, 2005, the Brasil Telecom shareholders' meeting renewed the entire board of directors, also appointing two directors, and respective alternates, designated by Telecom Italia International.

Further agreements were reached with Opportunity which provide for:

- the purchase, by Telecom Italia, of the stake held by Opportunity in Opportunity Zain (indirect parent company of Techold) and in Brasil Telecom Participações. Such purchase was intended to take place either when possible agreement is reached with the other indirect shareholders of Brasil Telecom, or at the latest, within 24 months;
- a settlement of a series of potential claims alleged by Opportunity which could have been judicially started against the Group.

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The first agreements provide for the payment of U.S.\$ 378 million by Telecom Italia (for the purchase of the investments); on April 29, 2006, however, the relevant agreements have terminated pursuant to their own provisions, prior to the consummation of any transaction thereunder, due to lack of satisfaction of the conditions stated in the agreements. Furthermore, Citigroup Venture Capital International Brazil, LP levied a provisional attachment in the Netherlands, on all claims that certain entities related to Opportunity had, or may have had, on the Equity Trust Escrow Services BV, with which Telecom Italia deposited an amount corresponding to the price to be paid to such Opportunity-related entities in case the conditions for the purchase of their shares in Zain and Brasil Telecom Participações would have been met.

Subsequent to the termination on April 29, 2006 of the relevant stock purchase agreements, Telecom Italia has instructed the escrow agent to release the funds to Telecom Italia immediately, as provided in the relevant escrow agreements. In view of the above mentioned attachment, however, the escrow agent has not yet released the funds; Telecom Italia has therefore initiated proceedings to obtain a judicial declaration in the Netherlands for the lift of such attachment and the release of the funds with the escrow agent. The second agreement provides for the payment of U.S.\$ 65 million for the settlement, which have been already paid.

V ETECSA

Through Telecom Italia International we hold a 27% interest in ETECSA, the monopoly provider of fixed line and mobile telecommunications services in Cuba. Old Telecom Italia obtained an initial stake of 12.25% in ETECSA in 1995, when, prior to its privatization by the Italian government, Old Telecom Italia acquired, for approximately U.S.\$291 million, a 25% stake in a Mexican telecommunications company which owned 49% of ETECSA. In February 1997, Old Telecom Italia converted its indirect stake in ETECSA into a direct investment and increased its interest to 29.29%. The acquisition price for such further 17.04% stake in ETECSA was U.S.\$ 291.6 million. In connection with the merger of the local mobile operators into ETECSA to form an integrated provider of telecommunications services we participated in a series of capital increases proportionate to our share ownership. These capital increases occurred during 2003 and through 2004; during this period we invested an additional U.S.\$41.3 million in ETECSA (through capitalization of dividends paid by ETECSA) and following these capital increases and the mergers we now own 27%. The other shareholders in the company include the Cuban government which controls 51% of the company and four other Cuban shareholders.

In addition to our shareholding in ETECSA Telecom Italia International is a party to a shareholders' agreement pursuant to which it has the right to designate certain senior executive officers and a majority of the board of directors of ETECSA on alternate years. In addition to these governance arrangements we entered into agreements to provide certain technical assistance to ETECSA with respect to its fixed line and wireless services. In return for these services we receive annual fees of U.S.\$900,000 (for fixed line technical assistance) and 950,000 (for mobile technical assistance) under each agreement respectively and certain other fees for specific services provided (1,518,000 in 2005). The level of the fees earned over the last two years is set forth in Note 39 Other Information -d) Related Party Transactions to Notes to our 2005 Consolidated Financial Statements included elsewhere herein. The technical agreement with respect to fixed line services expires at the end of 2006 and the technical agreement with respect to wireless services expires at the end of 2009.

As we own only 27% of ETECSA we account for its results under the equity method. For further details see Note 9 Other Non-Current Assets to Notes to our 2005 Consolidated Financial Statements included elsewhere herein. We do not believe that our arrangements with, and investments in, Cuba are material to the results of operations or financial condition of the Telecom Italia Group, taken as a whole.

4.2.6 COMPETITION

Fixed-line Domestic and International Telecommunications Services

As a result of the full liberalization of the market for telecommunications services in the Italian domestic market we have faced increasingly significant competition since 1998, including competition from foreign telecommunications operators.

The legal framework for regulation in the telecommunications sector in Italy was completely transformed as a consequence of the adoption of the Maccanico Law (effective August 1, 1997), the Presidential Decree No. 318/97

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(the Telecommunications Act) (effective September 22, 1997) and a series of Orders issued by the NRA which have been of relevance for the Telecom Italia Group as it has faced increasing competition. To date the regulatory environment has been characterized by an intensive implementation process in order to complete liberalization. See 4.3 Regulation .

Since the beginning of 1997, approximately 170 licenses have been granted in Italy, although at the end of 2005 only approximately 50 OLOs remained active and offered telecommunication services. In fact, in this period, many companies failed or were involved in merger and acquisition operations.

In 2005, competition in the Italian domestic market was driven by 5 players with differentiated business models and focusing on different market segments: Fastweb (a national player focused on broadband offers), Albacom (focused on business customers and voice/data bundled offers), Wind-Infostrada (an integrated fixed/mobile/internet operator focused on retail customers), Tiscali (a NB and BB internet Operator) and Tele2 (a voice and dial-up reseller, focused on retail Customers). The offering innovation consisted mainly of the introduction of bundled voice/broadband offers. The market development was characterized by a progressive migration from a reseller approach (CS/CPS for voice and Wholesale for ADSL) to an infrastructure-based approach (Shared Access or LLU).

Our market share in retail traffic volumes (retail voice and on-line traffic only) at December 31, 2005, was 72.6% compared to 72.2% at December 31, 2004 and 72.0% at December 31, 2003. Our most significant competitors in this segment are Tele2 and Wind; Albacom and Fastweb are less significant competitors but target specific markets (business customers for Albacom; high spending consumers for Fastweb).

In addition, the Italian fixed telecommunications market has been influenced by the development of mobile operators that attract voice traffic through their wide range of Value Added Services and more personalized terminals.

In this competitive environment Wireline was nonetheless able to increase revenues and improve profitability during 2005. The improvements were due to:

- the strong growth of Broadband with approximately 7 million access lines at the end of 2005, of which approximately 1.3 million in the European market, an increase of approximately 2.6 million accesses compared to 2004;
- significant revenue growth in ADSL (an increase of 40% compared to the end of 2004), Value Added Services on Data (an increase of 25.3% compared to the end of 2004) and Broadband Data Transmission (an increase of 15.7% compared to the end of 2004);
- the maintenance of the market share on traffic both on Voice and Online (an increase of 0.4% compared to December 31, 2004) due to a successful loyalty campaign, with more than 6.3 million loyalty packages subscribed, and limited impact on the customer base from the unbundling of the local loop.

The continued implementation of a new marketing approach on fixed line services by developing new handsets that enable customers to utilize video communication and, through a new mobile-like handset Aladino , innovative voice VAS (SMS, MMS, News, Weather and others), a first step towards more Personalized communication and Videocall .

We believe that our combination of service, performance, quality, reliability and price is an important factor in maintaining our strong competitive position.

Mobile Telecommunications Services

The Italian Mobile Market. The mobile telephone market continued to grow in Italy in 2005 and grew faster than in previous years with customer growth of 13.2% in 2005 compared to 10.8% in 2004 and 3.6% in 2003. By December 31, 2005, the number of cellular phone lines reached 71.5 million, corresponding to a penetration rate of around 123.5% of the population.

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This increase is mainly due to the performance of H3G(3), the operator offering exclusively UMTS services. Competition for mobile telecommunications services remained strong in 2005. Consequently, our strategy has been focused on strengthening our leadership with customers with a high mobile phone usage. Our strategy to attract and retain such customers has been to:

- offer innovative tariff schemes and services;
- focus on customer care and service for these valuable customers;
- quality performance;
- reinforce the core voice business; and
- introduction of the TIM s Way for 3G and development of the new generation of Mobile data .

There are three principal competitors to Mobile Italy in the Italian mobile market: Vodafone, Wind and H3G(3). At December 31, 2005 Mobile Italy remained the market leader with a market share of approximately 40%, with Vodafone, Wind and H3G(3) having market shares of approximately 33%, 19% and 8%, respectively. In 2005, we had a 29% market share of net additional GSM and UMTS lines, corresponding to 2.4 million net lines, compared to 1.6 million for Vodafone, 1.6 million for Wind and the remaining 2.8 million attributable to H3G(3).

Our figures do not include 422,000 silent lines in order to ensure greater consistency between the number of lines managed and business development.

The Italian market, which has a high penetration of prepaid cards, is characterized by certain customers acquiring multiple lines in order to take advantage of specific or time-limited commercial offers. Once these offers expire these customers tend not to continue the use of such lines which is facilitated by the prepaid nature of the arrangement. As a result, we exclude the silent lines in order to provide greater consistency between the number of lines managed by the Company and the development of the business.

We believe that the continuous improvement of the quality of our services and the strengthening of our leadership in network and marketing activities are important factors in maintaining our strong competitive position.

The Brazilian Mobile Market. There is significant competition in Brazil from a number of local and international operators, the most significant of which are Vivo (a Brazilian company owned by Telefonica) and Claro (a company owned by the Mexican group America Movil). We expect competition to increase in the future with continued consolidation in the market.

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The regulatory framework in Italy incorporates the EU regulatory framework based on the Framework directive together with three directives on Access , Authorization and Universal Service . These directives have been effective in the national regulatory framework since September 16, 2003. The new Electronic Communications Code (the Code) implemented the Directives and other regulatory interpretations and recommendations without substantial changes or departures from the text adopted at the European Union level. In implementing the Directives, the Code expressly abolished the former legal framework for regulation of the telecommunications sector in Italy which had been in effect since October 7, 1997 when the Italian telecommunications market became fully liberalized.

The main characteristics of the Code are as follows:

- redefinition of the concept of significant market power and of the criteria for imposing obligations on certain operators, with the introduction of market analysis;
- the introduction of the term electronic communication services and networks ;
- electronic communication services and networks can now be provided pursuant to a general authorization ;
- more flexibility by national regulatory authorities to select which access and interconnection obligations to impose on operators notified as having significant market power in a relevant market; and
- redefinition of certain measures relating to retail price regulation and extension of number portability to mobile operators.

Moreover, the Code provides for guidelines on market analysis and calculation of significant market power and refers to the relevant European Recommendation for the identification of the retail and wholesale markets where such analysis and identification is to be conducted. The Code also provides for, among other things, the following:

- allows the trading of the rights to the use of frequencies among operators offering the same type of services;
- provides for specific and more defined rules aimed at reducing the burden of current legislation and local regulations which regulate the installation of networks;

- redefines the assignment of roles and responsibilities among the Italian Ministry of Communications and the NRA mainly by assigning to the Ministry of Communications the task of supervising the authorization process and compliance with the universal service obligations and to the NRA the task of conducting market analyses and proposing remedies.

The Code also introduces a new definition of and specific references to broadband services , encouraging their development at a regional level. See 4.3.7 EU Telecommunications Law and Regulation The 1999 Review .

4.3.2 THE NATIONAL REGULATORY AUTHORITY

The National Regulatory Authority consists of a President appointed by the Italian Government through a Presidential decree, a Committee for Infrastructures and Networks, a Committee for Products and Services and the Council. Each of the Committees members is selected by the Italian Parliament and appointed through a Presidential decree. Each of the Committees and the Council is responsible for establishing regulations for their specific areas.

The Committee for Infrastructures and Networks, among other things, allocates radio frequencies relating to telecommunications services; defines objective and transparent criteria for establishing tariffs for interconnection and network access; regulates relationships among telecommunications companies; settles disputes regarding interconnection; and defines the scope of the universal service obligation and the operators subject to it, together with criteria for calculating and sharing its costs.

The Committee for Products and Services, among other things, regulates product quality and conformity with EU directives governing the relationship between companies controlling fixed or mobile telecommunications

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networks and telecommunications service providers and controls the operators compliance with regulation in the field of broadcasting activities.

The Council adopts regulations establishing criteria for issuing licenses for the telecommunications sector and for TV and radio activities (including cable and satellite broadcasting).

The NRA is responsible for:

- market analysis as defined by the Code;
- preparation of regulations in the telecommunications field;
- establishment of the criteria to be followed by operators in determining tariffs;
- monitoring operators to ensure their compliance with such tariff criteria;
- ensuring, where appropriate, accounting separation between different activities carried out by the same operator;
- monitoring of the performance of services to ensure compliance with contracts and qualitative levels of service;
- issuance of directives regarding quality of services;
- examination of complaints filed by users and customers in relation to quality of services and the level of tariffs;
- control of steps taken by operators to ensure equal treatment of their customers and verifying periodically the quality of the service provided; and
- control of operators compliance with the general principles issued by the Italian Government and the NRA in relation to public services.

The NRA has investigative powers, as well as the authority to impose sanctions on operators who do not comply with the directives and resolutions and to propose to the Ministry of Communications the revocation and/or suspension of general authorizations and individual licenses in the event of repeated violations by the holder.

4.3.3 THE CODE AND IMPLEMENTING REGULATIONS

The principal provisions contained in the Code, which affect the provision of telecommunications services by the Telecom Italia Group and its competitors in Italy relate to:

- universal service obligations;
- obligations imposed on operators having significant market power, in particular with respect to interconnection agreements and accounting policies;
- numbering (carrier selection, preselection, and number portability);
- rights of way;
- authorizations; and
- introduction of new broadband services.

V UNIVERSAL SERVICE OBLIGATIONS

The universal service obligations include the provision of fixed-line public voice telephony service, publication of telephone directories, public payphones, free emergency call services and special services for disabled or disadvantaged people. To date Telecom Italia is the only operator subject to the universal service obligations, although similar obligations could be imposed on other operators. The net costs for the provision of the universal service are calculated on a long run forward-looking incremental cost basis. The telecommunications operators providing fixed-line public voice telephony service or mobile and personal communications services are required, under certain circumstances, to contribute to such costs.

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Telecom Italia submits on an annual basis the net cost of providing universal service. The NRA has recognized a net cost for the provision of the universal service for 2001 and 2002 (40.7 million for 2001 and 37.2 million for 2002). Of these amounts 23.2 million and 24.0 million for each of 2001 and 2002 are to be reimbursed by other OLO s (TIM included). Due to various administrative disputes we have received to date only full reimbursement for 2001. However, recent decisions by the administrative courts have confirmed that all amounts are to be paid by OLOs.

The net cost of providing the universal service for years subsequent to 2002 has not yet been determined by the NRA, although we have submitted the net costs of providing universal service for the years 2003 and 2004.

Telecom Italia was confirmed by the Code as the operator with the obligation to supply the Universal Service under the conditions laid down in the regulations.

V SPECIAL STATUS OF OPERATORS HAVING SIGNIFICANT MARKET POWER

In the old regulatory regime telecommunications operators operating fixed-line or mobile networks, or offering fixed public voice telephony services, leased lines or international circuits, were subject to special obligations with respect to interconnection and accounting policies if they had Significant Market Power (SMP). An operator was presumed to have Significant Market Power if its share of the relevant market was greater than 25%, although the NRA might determine that an operator having a market share greater than 25% did not have Significant Market Power, in view of the operator s ability to influence market conditions and its access to financial resources, or that an operator with a market share lower than 25% had such power.

In April 1998, Telecom Italia was identified as the sole operator having Significant Market Power in the markets of fixed telecommunications networks, fixed-line public voice telephony services, leased lines and interconnection services. In April 1998, TIM was identified as having Significant Market Power in the market of mobile telecommunications services. With order 197/99 the NRA in September 1999 determined that TIM and Omnitel had Significant Market Power for mobile telecommunications services and for domestic interconnection.

Since 2000, the NRA has confirmed that:

- (i) Telecom Italia had Significant Market Power in the markets of public fixed telephone networks and services, leased line systems, and the national interconnection market;
- (ii) TIM (Mobile Italy) had Significant Market Power in the markets of public mobile and national interconnection communications systems (termination); and
- (iii) Vodafone Omnitel had Significant Market Power in the markets of public mobile and national interconnection communications systems (termination).

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In 2002 the NRA concluded its inquiry with the aim of identifying the operators with Significant Market Power in the Internet access market (Order No. 219/02/CONS). This Order identified Telecom Italia and Wind as operators with Significant Market Power in the market of calls terminating on the Internet using dial-up technology, and also identified Telecom Italia alone in the final market of switched Internet access services from the fixed network.

With the introduction of the new European Framework in August 2003, criteria for the identification of Significant Market Power changed as 18 separate markets have been identified and the NRA is to carry out a separate Market Analysis in each market, in order to identify:

- the level of competition in each market;
- the need to indicate one or more operators as having Significant Market Power; and
- the appropriate remedies, i.e. the rules to apply, to ensure appropriate competition.

As of December 31, 2005 the NRA had carried out the public consultation process concerning the following markets:

- Publicly available local and/or national telephone services provided at a fixed location for residential and non residential customers (markets No. 3 and No. 5 of the EC Recommendation Order No. 410/04/CONS).

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- The minimum set of leased lines which comprises the specified types of leased lines up to and including 2Mb/sec (market No. 7 of the EC Recommendation Order No. 411/04/CONS).
- Publicly available international telephone services provided at a fixed location for residential and non residential customers (markets No. 4 and No. 6 of the EC Recommendation Order No. 414/04/CONS).
- Wholesale unbundled access (including shared access) to metallic loops and subloops for the purpose of providing broadband and voice services (market No. 11 of the EC Recommendation Order No. 415/04/CONS).
- Voice call termination on individual mobile networks (market No. 16 of the EC Recommendation Order No. 465/04/CONS).
- Call origination, call termination and transit services on the public telephone network provided at a fixed location (markets No.8, 9 and 10 of the EC Recommendation Order No. 30/05/CONS).
- Access to the public telephone network at a fixed location for residential and non residential customers (markets No. 1 and 2 of the EC Recommendation Order No. 69/05/CONS).
- Wholesale broadband access (market No. 12 of the EC Recommendation Order No. 117/05/CONS).
- Wholesale terminating and trunk segments of leased lines (markets No. 13 and 14 of the EC Recommendation Order No. 153/05/CONS).
- Access and call origination on public mobile telephone networks (market No. 15 of the EC Recommendation Order No. 306/05/CONS).

As of December 31, 2005, only nine markets (No. 1, 2, 7, 11, 12, 13, 14, 15 and 16) have been notified to the EU Commission.

Public consultation for market No. 17 (wholesale national market for international roaming on public mobile networks) and market No. 18 (broadcasting transmission services, to deliver broadcast content to end users) has not started yet.

With particular reference to market No. 17 (international roaming), the NRA held back until the end of 2004 from carrying out their analyses of such a market as they were awaiting action by the EU Commission in the international roaming inquiry. On December 10, 2004 the European Regulators Group (ERG) launched a joint market analysis scheme. On May 25, 2005, ERG launched a consultation on a common position paper concluded by September 2005. Drawing on the ERG final common position paper, the NRA will then proceed with its analysis of market No. 17.

The conclusion of the market analyses process with the publication of the final decisions is expected during 2006.

Interconnection

Telecommunications operators providing fixed-line public voice telephony services, mobile telecommunications services or leased line systems and having Significant Market Power are required to negotiate and enter into interconnection agreements at the request of other operators wishing to provide telecommunications services, to apply non-discriminatory terms and to communicate copies of their interconnection agreements to the NRA. Public fixed network operators and leased line service providers having Significant Market Power are required to publish yearly a Reference Interconnection Offer (RIO).

On February 27, 2003 the NRA introduced a network cap , a mechanism for defining in advance the rules for pricing RIO services according to the RPI (Retail Price Index) and productivity factors. The network cap applies to the period 2003-2006. The NRA also established non discrimination criteria in interconnection and wholesale market between Telecom Italia and the other licensed operators:

- same conditions for other licensed operators as applied to Telecom Italia s retail units;
- further obligations of accounting separation;
- functional separation between network and retail units; and
- price squeeze tests for retail offers(*).

(*) There is a price squeeze if the margin between the wholesale tariffs and the retail tariffs of the SMP telecommunications operator is so small that efficient competitors are no longer able to profitably offer their services.

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Telecom Italia has had a number of RIOs approved by the NRA since 2003, the most recent of which was approved by the NRA on March 17, 2005. Moreover, we have voluntarily undertaken measures (i.e. reduction in the interconnection charges) to support competition (so called *Accordi Parcu*).

On October 28, 2005 we published the RIO 2006. On November 30, 2005 the NRA began evaluating our offer, setting January 31, 2006 as the date to conclude its evaluation; however, a financial decision has not been taken yet.

As part of the market analysis process, the NRA has proposed to revise the network cap mechanism which applied to the 2003-2006 period (public consultation on relevant markets No. 8-9-10 still ongoing).

Local Loop Unbundling (LLU)

In 2000, the NRA published the general guidelines regarding the services that must be offered by Telecom Italia on an unbundled basis: twisted copper pairs; fiber optics; access extension (lines between switches), and digital transmission channels (i.e., digital circuits between the local office of Telecom Italia and the operator's point of presence) and the related economic pricing criteria, based on fully distributed historical costs. The guidelines allow other operators to have direct access to end users (customers) by leasing the network components from Telecom Italia (full unbundling) as well as leasing only the high bandwidth (shared access).

On May 12, 2000, we put forward a Reference Offer for Local Loop Unbundling, for approval by the NRA. The NRA finally issued orders on December 30, 2000 and in January 2001. The orders dealt with the technical and procedural aspects of the provisioning of local loop unbundling and co-location as well as the rates for the unbundled services.

We published a revised Reference Offer for 2000 on January 31, 2001.

On June 24, 2002, we presented to the NRA a *Virtual Unbundling* offer, which offers carrier preselection, inclusive of the payment for the unbundling charge wherever it is temporarily impossible to offer co-location. On September 16, 2002, we further reduced the price of some unbundling services.

Order No. 02/03/CIR confirmed the monthly rental fees of LLU and set a reduction of activation fees. As regards co-location services, the Order asked the application of our internal costs (approximately a decrease of 40%) to the square-meter costs for co-location paid by OLOs. Furthermore, the integration of the offer with the coming services is required.

In 2003, our published RIO fixed the price for the monthly rental fee for LLU, at 8.30, represented the best price in the EU Countries (the incumbent Danish operator price). Order No. 11/03/CIR included additions and changes, particularly regarding the application

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of the network-cap mechanism, introduced with Order No. 03/03/CIR, for the offer of certain interconnection lines, and for co-sharing, local loop unbundling, partial lines and permanent virtual lines services.

We published the RIO 2004 on October 31, 2003, maintaining the same level of price for LLU service (8.30 per month) as the RIO 2003 (even though the incumbent Danish operator price for LLU has now increased to 8.60).

In December 2005, around 1,341,000 unbundled lines were in place and 1,120 sites were ready for co-location.

We published the RIO 2005 on October 29, 2004, maintaining the same level of price for LLU (8.30 per month) as the RIO 2004. Moreover, in order to support competition, we have voluntarily undertaken the following measures for the period 2005-2006:

- the fee for qualification of the ADSL pair will not be applied for all the new lines;
- we will not increase the LLU monthly rental for the POTS/PSTN pair above 8.30 per month until December 31, 2006;
- bonus of 9.60 per year, applied on monthly basis, for each existing or new LLU line.

We published RIO 2006 on October 28, 2005, maintaining the same level of price for LLU (8.30 per month) as the RIO 2005.

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The NRA notified market 11 to the Commission and to the other national regulators under article 7 of the Framework Directive on September 22, 2005.

The NRA has proposed the introduction, for the years 2006 and 2007, of four baskets of LLU services each of which would be subject to a cap of RPI 4.75% per year:

- Basket A: one-off and monthly charges for full LLU and sub-loop unbundling;
- Basket B: one-off and monthly charges for shared access;
- Basket C: one-off and monthly charges for access extension circuits;
- Basket D: one-off and monthly charges for numeric channel service (offered where unbundling is not possible).

The starting prices for the annual reductions are those contained in the 2005 reference offer.

Leased Lines

Telecom Italia published a new retail and wholesale leased line offer that was approved by the NRA on January 29, 2004.

This offer in contrast to previous offers introduced a price reduction of between 5.25% and 7% for the retail offer and of 12% for the wholesale offer.

Public consultation on market No. 7 is ongoing.

On November 28, 2005, the NRA notified a draft measure concerning the retail market for leased lines in Italy but by notice of December 22, 2005, the NRA withdrew the aforementioned notification. The NRA will notify a revised draft in 2006.

With respect to the wholesale offer, our obligations are currently under review in the market analysis process. In particular, NRA notified markets No. 13 and 14 to the EU Commission and other national regulatory authorities under article No. 7 of the Framework Directive on October 28, 2005.

Among the remedies foreseen by NRA are price controls through a network cap based on cost orientation for the years 2006-2008. The starting prices are to be set in the reference offer 2006 followed by reductions in line with the caps shown in the table below in 2007 and 2008.

Basket	Content	Annual reductions for 2007 and 2008
A	Terminating segments up to and incl. 2.5 Gbps	RPI-9.6%
A.1 (sub-basket)	Terminating segments up to and incl. 155 Mbps	No sub-cap
A.2 (sub-basket)	Terminating segments above 155 Mbps up to and incl. 2.5 Gbps	RPI+0%
B	Trunk segments from 2 Mbps up to and incl. 2.5 Gbps	RPI+0%
C	Interconnection links at regional level up to and incl. 2.5 Gbps	RPI-9.6%
D	Interconnection links at local level up to and incl. 2.5Gbps	RPI-9.6%
E	Internal exchange connections up to and incl. 2.5 Gbps	RPI-RPI

We must set starting prices in 2006 for services in baskets A.1, C, D and E in line with costs from our regulatory accounts for the year 2004. The starting prices in 2006 for services in baskets A.2 and B are not to exceed the current regulated prices for the terminating and trunk segment parts respectively of our wholesale end-to-end leased lines approved by the NRA in Order No. 440/03/CONS.

Mobile Termination Rate

In 2003, the NRA set the maximum values for termination rates applied by mobile operators having Significant Market Power (TIM and Vodafone Omnitel) for calls originated on fixed networks. The ceilings for mobile termination charges were established at 14.95 euro cents per minute, as from June 1, 2003.

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For the non Significant Market Power mobile operators (Wind and H3G) the NRA did not establish any ceiling for the termination rates applied to their networks.

On June, 24, 2005, the NRA notified all of the Italian Mobile Operators, including Telecom Italia, of the opening of a procedure aimed at the adoption of a possible provisional measure concerning the maximum price for termination of voice calls on individual mobile networks.

On July, 19, 2005, the NRA issued an order on urgent measures concerning maximum prices for termination of voice calls on individual mobile networks in which all four Mobile Operators are considered to have Significant Market Power.

From September 1, 2005, average Mobile Termination Rate shall not exceed 12.10 euro cent per minute for TIM and Vodafone and 14.35 euro cent per minute for Wind.

The measure, which has extended regulation of Fixed-Mobile to Mobile-Mobile, is in force until formal conclusion of the relevant market analysis.

On December 1, 2005 the NRA notified market No. 16 to the EU Commission and other national regulators under article No. 7 of the Framework Directive. Among the remedies proposed by the NRA the most important is the introduction of a network cap for the years 2006-2008 for TIM, Vodafone and Wind. The network cap set the following values:

<u>Operator</u>	<u>Current charge* eurocents/min</u>	<u>From July 1, 2006 eurocents/min</u>	<u>From July 1, 2007</u>	<u>From July 1, 2008</u>	<u>Cost oriented target charge by July 1, 2008 eurocents/min</u>
TIM	12.10	11.20	RPI-13%	RPI-13%	8.90
Vodafone	12.10	11.20	RPI-13%	RPI-13%	8.90
Wind	14.35	12.90	RPI-16%	RPI-16%	9.50

* As set on July 19, 2005 when the NRA imposed reductions in the mobile call termination rates of TIM, Vodafone and Wind from September 1, 2005 as a provisional measure pending completion of its analysis of market No. 16.

The NRA determined that it would currently not be proportionate to impose price control and cost accounting obligations on H3G. However, the NRA stated that it would review this decision before July 31, 2006.

Accounting Policies

Telecom Italia cost accounting policy. Operators having Significant Market Power are required to have an accounting system showing their costs in a transparent manner. Upon request, such operators must provide the NRA with a description of their cost accounting system to verify compliance with the provisions of the electronic telecommunications regulatory framework. Moreover, operators of fixed public networks and mobile networks and providers of fixed public voice telephony services, mobile telecommunications services and leased line services with significant market power must keep a separate accounting system distinguishing between the activities related to the building and operation of public telecommunications networks, the activities related to the provision of telecommunication services, the interconnection offering and the universal service provision.

The NRA chose KPMG as the independent advisor for the auditing of the accounting separation reports. The accounts supplied for 2001 have now been fully audited. Accounts for subsequent years have been timely supplied by Telecom Italia but remain subject to audit due to the NRA's delay in appointing the auditor.

TIM cost accounting policy. In 1999, TIM and Vodafone Omnitel were notified as operators with Significant Market Power in the national interconnection market and must provide a cost oriented fixed-mobile termination rate.

At that time, TIM was required to implement cost accounting reporting in order to calculate a fixed-mobile termination rate. In 2001, TIM produced a cost accounting system based on Fully Allocated Historical Cost Data for the year 1999 (positive certification was issued by the advisor of the NRA at the end of 2002). It also introduced an accounting system based on a FAC-CC model (Fully Allocated Cost on a Current Cost basis), as an intermediate step towards the adoption of long-run incremental costs to determine the fixed mobile rates.

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With Order No. 47/03/CONS, the NRA decided to implement a three-year Network Cap mechanism (2003-2005) to be applied to the termination rate, in order to grant a gradual reduction of this price. The application of the mechanism over the next few years will be subject to a new decision, after the completion of the incremental cost modeling, and after the evidence forthcoming from the Market Analyses, under the Code.

V NUMBERING

In accordance with the Telecommunications Regulations and by the issuance of various Orders the NRA issued regulations related to Number Portability and Carrier Preselection as described below.

Number Portability (NP)

Since February 2000, Service Provider Portability in fixed networks was introduced, including Non-Geographic Numbers (Premium Rates, Freephone Numbers, and Splitting Charges).

Service Provider Portability allows an end user to retain his number independent of the organization providing service, in the case of geographic numbers at a specific location (same Local Area) and in the case of other than geographic numbers at any location. NP for non-geographic numbers started in May 2000. NP for geographic numbers has been implemented, as well as its synchronization with the unbundling of the local loop.

NP for mobile services was established during 2001 and commenced in April 2002.

On March 28, 2002, the NRA issued Order No. 7/02/CIR which established that the price of Mobile NP (per number costs) had to be equal to the one-off price that the operator receiving the customer (the recipient) had to pay to the operator giving the customer (the donor). In January 2003, the NRA with Order No. 13/02/CIR set a price cap for the portability charge. This charge can not be higher than the price established for Number Portability between fixed operators.

Carrier Preselection (CPS)

Carrier selection (call by call) has been operational since the end of 1998 for long distance (national and international) and fixed mobile calls. Carrier selection for local calls has been available since January 2000.

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Since February 2000, in accordance with Order No. 3/99/CIR and No. 4/00/CIR, which introduced new obligations for the provision of Carrier Preselection (i.e., timing, minimum daily number of user activations), customers can make inter-district, international calls and calls to mobile networks using a pre-selected carrier as an alternative to Telecom Italia, without dialing the identifying code required. Since July 2000 customers have also been able to make local calls (within the same district) with a pre-selected operator.

Since April 2003, we have been subject to regulations which define common measures relating to the disconnection of the CPS service, describing in detail the modes and time-scales involved in the disconnection of CPS services, to safeguard users, and stating precise obligations with regard to transparency for operators of the services.

In August 2003, Telecom Italia and other numerous operators signed an agreement regulating the operational modalities for the management of the communication of the CPS service cessation.

As from RIO 2005, the surcharge for single minute of CPS traffic is no longer applied and the one-off activation charge amounts at 5.46 per line, decreased by 18% compared to the same price in RIO 2004.

In the management of activation/de-activation process of the CPS service, we operate in accordance with the applicable Orders. In the event of services contested by the client since not requested, we intervene, in compliance with the regulation, for the timely restoration of the previous configuration of the line.

V **DIRECTORY INFORMATION SERVICES**

The new Electronic Communications Code (the Code) excludes the provision of directory information services from the applications of the universal service related obligations as, since October 1, 2005, the market of directory inquiry services is liberalized.

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The opening to the competition of the market of Directory enquiry services was set by the NRA with Order No. 15/04/CIR (November 2004), which *inter alia* established the mandatory interoperability of these services on 12xy numbers (i.e. services should be accessible by all customers of all providers).

Order No. 12/05/CIR (May 2005) provided as of October 1, 2005 for the opening of the 12xy numbers and stated that the offer of directory enquiry services based on previously used numbers (for example 412) had to stop since December 1, 2005.

V RIGHTS OF WAY

The Telecommunications Regulations prohibit public authorities from discriminating in the granting of rights of way for the installation of public telecommunications infrastructures. The NRA and the local public authorities can promote the sharing of such structures and rights of way. If the access to such rights of way cannot be granted to a new operator, the NRA and the local public authorities can allow the access to existing infrastructure. The parties involved agree on the commercial terms of the sharing of the existing infrastructure.

Decree Law No. 198 of September 4, 2002, established fundamental principles with regard to the installation and alteration of telecommunications infrastructures that are regarded as strategic, and fixed precise terms for the issue of authorizations, abrogating the procedure of environmental impact assessment (VIA) and limiting the financial responsibility of companies to expenses associated with installation operations, digging and occupation of public property. Law No. 166 of August 1, 2002, also defined the new standards relating to the installation, access and sharing of multi-service cables and of cable ducts that need to be built following construction and maintenance work on civil works.

The regulation of the rights of way is now exhaustively treated in the Code.

4.3.4 PUBLIC CONCESSIONS

In 2001 the NRA issued three individual licenses and a general authorization to Telecom Italia:

- An individual license for the installation and provision of public telecommunications networks, and for the provision to the public of voice telephone services (modification of the concessions and associated agreements formerly granted to SIP, Iritel and Italcable).
- An individual license for the installation and operation of a network of coastal stations with the aim of providing mobile maritime services via Inmarsat satellite (modification of the concession and associated agreement formerly granted to Iritel).

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- An individual license for the plant and operation of radio-electric boarder stations, and the supply of mobile maritime services and mobile services via satellite through Inmarsat terminals (modification of the concession and associated agreement formerly granted to Sirm).
- Authorization for the supply of satellite network and communications services (modification of the concession and associated agreement formerly belonging to Telespazio).

The licenses and authorizations issued to Telecom Italia had the same 2012 expiry date as the Public Concessions.

Pursuant to Law No. 448 of December 23, 1998, a new fee was instituted from January 1, 1999, to take the place of the license fee payable under the previous regulatory regime. The amount of the operating fee was based on a sliding scale (2.5% for 2001, 2.0% for 2002 and 1.5% for 2003). The Ministerial Decree of March 21, 2000 established that the fee should only be applied to revenues from installation activities and the supply of public telecommunications networks, local telephone service and mobile and personal service.

However, by Order of September 18, 2003 (joint cases No. C 291/01 and No. C 293/01), the Court of Justice of the European Community stated that the aforementioned telecommunications license fee established by Italian Law No. 448/1998, Art. 20, was contrary to EU law. The same conclusion was reached by the Italian administrative tribunal (TAR) on January 5, 2005 (see also Note 25-Commitments and Potential Liabilities of the Notes to the Consolidated Financial Statements).

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In March 2001, the GSM Concessions to the mobile operators, including TIM, were transformed into individual licenses.

With the publication of the Code all the existing licenses have been automatically transformed into general authorizations (with the attribution of individual rights for the use of frequencies).

4.3.5 LICENSES

In October 2003, the number of operators licensed for the provision of both fixed voice telephony service and building public telecommunications networks and for mobile and satellite services granted by the Ministry of Communications and the NRA was approximately 160.

In the segment of mobile telecommunications services, one license was granted to the third national mobile operator (DCS-1800, GSM) Wind, which started on March 1, 1999, and another license (only for DCS-1800) was granted to the fourth national operator Blu, which started on May 16, 2000. Wind is the sole Italian telecommunications operator that was granted both a mobile and a fixed license at the time it started its operations. Fixed licenses have also been awarded to TIM (February 2001) and Vodafone Omnitel. Mobile telecommunications services based on the DCS-1800 technology are also provided by the two GSM operators, TIM and Vodafone Omnitel.

The Italian government awarded five UMTS licenses in Italy in December 2000. TIM, together with Vodafone Omnitel N.V., WIND S.p.A., Andala S.p.A. (now H3G S.p.A.) and IPSE S.p.A., were awarded licenses to provide the third generation mobile services. TIM committed to pay 2,417 million for its license, which has been paid in installments.

In 2002, Blu, the fourth operator, was acquired by TIM, with its customers transferred to Wind.

In accordance with Presidential Decree No. 211 of August 1, 2002, the duration of all individual licenses is 20 years (before such decree the duration was 15 years).

As already stated with the publication of the Code all the existing licenses have been automatically transformed into general authorizations.

XDSL/ATM Broadband

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In December 1999, we received a temporary authorization from the NRA for the wholesale offering of ADSL/ATM access service to Other Licensed Operators and Internet Service Providers. In February 2000, we started the always on retail offering for fast Internet access. The ADSL 640 wholesale offer was partially modified by the NRA in April 2000. In February 2001, the NRA approved the Permanent Virtual Circuit (ADSL up to 2 Mbit/s and HDSL up to 155 Mbit/s technologies) offer as presented by Telecom Italia and authorized us to offer XDSL retail services branded as RING and FULL BUSINESS COMPANY.

On April 15, 2003, the NRA approved our wholesale x-DSL offer for wholesale services which operators acquired from us in order to supply ADSL to the public, unless they had their own infrastructures or used unbundling. The new range of services included price reductions for ADSL access, the introduction of longer time-scales for starting to market new wholesale services based on the retail-minus principle, and the integration of an operator Service Level Agreement with regard to the disconnection of services.

On October 3, 2005, the NRA notified market No. 12 concerning Broadband Wholesale Access to the EU Commission and the other national regulators under article 7 of the Framework Directive.

The NRA defined the relevant product market as wholesale broadband access by means of xDSL, fiber optic and satellite technologies and designated Telecom Italia as having Significant Market Power. Among the remedies proposed by NRA there is the introduction of an obligation of interconnection to:

- DSLAM (only in areas non opened to LLU) with cost orientation;
- Parent switch (ATM or IP) with cost orientation;

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- Distant Switch (ATM or IP) at commercial conditions; and
- IP managed level at commercial conditions.

It is foreseen that in the transition phase we can continue to adopt in the determination of ADSL wholesale services the retail minus approach as set in Order 6/03/CIR but the minus must to be set not lower than 30%.

4.3.6 TARIFF AND PRICING POLICY

Overview

Telecom Italia operates in both domestic and international markets. Our pricing policy is established in accordance with existing regulations for regulated services, and in accordance with market and competitive factors.

Fixed Network. Management believes that it is essential for Telecom Italia to have the flexibility to price its telecommunications services selectively in order to counter increased competition.

In 1999, the NRA described the rules to be applied by Telecom Italia in setting the tariffs for its services. The NRA distinguished between two kinds of tariffs. The first required prior approval by the NRA and applied to:

- services under a price-cap obligation (RPI-X): the X is differentiated according to different levels of competition in the provision of the various telecommunications services (such as installation, connection charge, local voice calls, long distance voice calls, international voice calls);
- services under cost-orientation and accounting separation obligations: Interconnection, Special Access and Leased Lines, due to the Significant Market Power of Telecom Italia in the provision of these services; and
- services to be kept affordable, on the basis of the regulation concerning the universal service obligation.

The second category of tariffs required only a prior communication to the NRA itself and applied to so-called value added services for which a high level of competition exists.

In 2003, the NRA set out the rules to be applied by Telecom Italia in setting tariffs for the services offered for the years 2003-2006, introducing a safeguard cap with the aim of maintaining price stability.

The safeguard cap system provides for 3 different caps:

- access services, such as installation and connection charge: RPI-0 as well as a sub-price cap for residential subscription charges of RPI-RPI;
- traffic services, such as local voice calls, long distance voice calls: RPI-RPI; and
- fixed/mobile services, limited to the fixed call segment belonging to Telecom Italia (the Retention segment): RPI-6%.

In the public consultation document No. 410/04/CONS dated November 24, 2004, concerning markets No. 3 and No. 5 (respectively, publicly available local and/or national telephone services provided at a fixed location for residential customers and publicly available local and/or national telephone services provided at a fixed location for non-residential customers) the NRA proposed to maintain the same price cap mechanism for the local, national long distance and fixed to mobile (Retention segment) telephone services. The draft decision of the NRA has not been notified yet to the EU.

With respect to access to the PSTN, the NRA notified to EU markets No. 1-2 (respectively Access to the public telephone network at a fixed location for residential customers and Access to the public telephone network at a fixed location for non-residential customers) on October 10, 2005. The NRA proposes to impose the following regulatory obligations on Telecom Italia.

At the wholesale level:

- Provision of wholesale line rental (WLR), restricted to local exchanges in areas where full LLU and shared access are not available, according to retail minus pricing. For years 2006 and 2007, the WLR

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price is to be set based on our retail line rental for residential and non-residential customers minus 12%. NRA will set up a technical working group with Telecom Italia and alternative operators to assist in the preparation of the Telecom Italia WLR reference offer and implementation.

- Transparency. We are required to publish an annual WLR reference offer and service level agreement.
- Non-discrimination.
- Accounting separation.

At the retail level:

- Introduction of a price cap applied to two separate baskets of line activation and line rental charges for both PSTN and ISDN, one basket for residential customers and one for non-residential customers. For the years 2006 and 2007, NRA has decided to set the cap for the basket for residential customers to RPI RPI per year and the cap for the basket for non-residential customers to RPI 0% per year.

For further details, see Item 4. Information On The Telecom Italia Group 4.2 Business Units 4.2.1 Wireline Traffic and Tariffs Domestic Tariff Rebalancing .

4.3.7 EU TELECOMMUNICATIONS LAW AND REGULATION

Italy is a member of the EU and, as such, is required to implement the directives issued by the EU. Although directives must be incorporated into domestic legislation to be fully effective, a directive or certain provisions of a directive may take effect automatically in a Member State on the prescribed deadline if they are sufficiently clear and specific, even if they are not formally adopted by such Member State by the prescribed deadline. If a directive is not formally implemented by the prescribed deadline the only remedy available for an interested party is to seek damages against the Member State. Italy is also the addressee of various EU resolutions, recommendations and communications which are not legally binding, although politically important. The European Commission began opening the telecommunications market to competition with the adoption of directives in the late 1980s and early 1990s which beginning in 1990, opened to competition telecommunication services, other than fixed public voice telephony services, opening the market for value added services. Subsequent directives liberalized the market for satellite services, alternative infrastructure and mobile services and infrastructure. These liberalization measures culminated with the opening of competition in 1998 of public voice telephony and public network infrastructure. These directives were also accompanied by directives relating to open networks, setting out a body of principles for access to public telecommunications networks and services.

The 1999 Review

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It was intended that the European 1998 regulatory package be reviewed by January 1, 2000. The Commission started a number of studies on the following subjects: (i) remaining barriers in the EU-wide telecommunications market; (ii) assessment of the interconnection situation in the EU; (iii) fixed-mobile convergence/integration; (iv) consumer demand; (v) quality of telecommunication services and consumer protection; (vi) need for a European regulator; and (vii) universal service obligations.

As a result of the above-mentioned studies, the Commission proposed the following five Directives:

- a common regulatory framework for electronic communications networks and services (Framework Directive);
- the authorization of electronic communications networks and services (Authorization Directive);
- access to, and interconnection of, electronic communications networks and associated facilities (Access Directive);
- universal service and users rights relating to electronic communications networks and services (Universal Service Directive); and
- the processing of personal data and the protection of privacy in the electronic communications sector (Personal Data Directive).

The Framework, Authorization, Access and Universal service Directives were adopted in March 2002 and published in the Official Journal on April 24, 2002. Member States had to adopt these Directives into their own laws by July 24, 2003. In Italy these Directives became effective as of September 16, 2003 through the adoption of the Code.

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Framework Directive. In an important change described by the Commission as rolling back regulation, the Directive redefines the concept of Significant Market Power and the threshold for imposing obligations on certain operators. The directive amends the current definition of Significant Market Power based on a 25% or more share of the relevant market.

In the Directive, the notion of Significant Market Power is based on the concept of dominant position, calculated in a manner consistent with competition law practice. Significant Market Power implies the application of rules in accordance with the conditions imposed by the other Directives.

Authorization Directive. The Authorization Directive provides for electronic communications services and networks to be provided under general authorization. Licenses will no longer be required and specific rights of use would be granted, separately from authorizations, for the assignment of radio frequencies and numbers.

A notification will be required only for the following elements:

- a declaration of the intention to start operation;
- contact information of the company requesting the authorization; and/or
- a short description of the service provided.

Upon notification the company can start to operate a network and provide services, provided that it has the right to use radio frequency and numbers if needed. No information should be required prior to, or as a condition for, market access. Nonetheless, Member States could require some justified information (listed in the proposal) from undertakings.

Access Directive. The Access Directive represents a significant departure from the previous Interconnection Directive 97/33/EC which sets out common obligations to be followed by Significant Market Power operators in all Member States.

Under the Access Directive, the national regulatory authority will have flexibility to select which access and interconnection obligations to impose on operators notified as having Significant Market Power in relevant markets. A maximum list of obligations is contained in the directive. The proposed operators with rights and obligations to interconnect are essentially the same as those defined in the current ONP Interconnection Directive.

National regulatory authorities will carry out an analysis of the competitiveness of a designated list of relevant product and service markets and identify which operators (if any) have Significant Market Power on any of the particular markets. A national regulatory authority will be able to impose price controls, including obligations for cost orientation of prices and obligations concerning cost

accounting systems, for the provision of specific types of interconnection and/or access services.

National regulatory authorities will also be able to impose obligations for transparency, non-discrimination, and accounting separation on Significant Market Power operators in relation to interconnection and/or network access. These obligations are carried over from the current regulatory framework.

Universal Service Directive. The Universal Service Directive replaces the existing directive on voice telephony and universal services. The Directive also contains rules on number portability, carrier selection and carrier pre-selection which are currently in the Interconnection Directive. The directive also covers the provision of leased lines and other mandatory services as well as a number of issues concerning users' rights, such as contracts, tariff transparency and information and quality of service.

In general, the existing requirements for the provision of universal service, voice telephony facilities and leased lines will remain in place, at least for the time being. The principal changes are described below.

In an important section on retail price regulation (up to now only covered in national law), it is proposed that, when an operator has Significant Market Power in the provision of access to, and use of, public telephone services, the national regulatory authority must:

- determine appropriate mechanisms for retail price control, such as price caps or specific price floors and ceilings;

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- ensure that the Significant Market Power operator sets prices at normal commercial levels;
- notify to the Commission the names of organizations subject to retail price control; and
- retail price control mechanisms should not be applied where effective competition exists.

The directive also provides for the extension of the requirement for number portability to mobile operators.

Guidelines on Market Analysis

In March 2001, the European Commission published Draft Guidelines on market analysis and the calculation of Significant Market Power. The European Commission called for public comments and an exchange of views among the interested authorities and different market operators. The Guidelines set out the principles for use by national regulatory authorities in the analysis of effective competition, when determining whether an operator has significant market power. Operators having Significant Market Power may be subject to obligations under other Directives in the regulatory package. The guidelines were adopted in July 2002.

On June 17, 2002, the European Commission issued the draft of the Recommendation on the list of markets to which the new framework will be applied and a working document, for opening the public consultation on the Recommendation in accordance with Art. 15(1) of the Framework Directive. The Recommendation was adopted in February 2003.

Recommendation on relevant markets

Article 15(1) of the Framework Directive requires the European Commission to adopt a Recommendation on relevant product and service markets. The Recommendation aims at identifying markets for which competition law remedies may be insufficient to effectively redress possible market failures.

The Recommendation was adopted on February 11, 2003 and identifies 18 relevant markets at retail and wholesale level. The range of different network structures and technologies deployed across the EU means that in some cases national regulatory agencies must decide the precise geographical boundaries between, or elements within, particular product and service markets identified in the Recommendation. National regulatory authorities may identify markets that differ from those of the Recommendation, provided they act in accordance with Article 7 of the Framework Directive.

Recommendation on remedies

The recommendation is under preparation by the European Commission. The purpose of this recommendation will be to indicate to the respective national regulatory authorities which remedies have to be applied in accordance with the principle of proportionality in order to achieve the objectives set out in the Framework directive. An ERG (European Regulators Group) common position was adopted in April 2004.

4.3.8 COMPETITION LAW

We are subject to Law No. 287 of October 10, 1990 (Law 287), the Italian competition law of general application, to the substantive rules of the Maccanico Law (Law 249) and to the competition rules of the EU. Law 287 forbids:

- agreements (including resolutions and concerted practices) aimed at fixing prices, limiting production or access to markets and technological developments, sharing of markets, applying different conditions for the same services to the detriment of competitors, and subjecting contracts to the acceptance of conditions that, according to their nature and common practice, are not linked to the object of the contract;
- abuses of dominant position (including practices aimed at fixing prices, limiting production or access to markets and technological developments, applying different contractual conditions for the same services to the detriment of competitors, as well as subjecting contracts to the acceptance of conditions that, according to their nature and common practice, are not linked to the object of the contract); and
- concentrations of enterprises (i.e., mergers, acquisitions of controlling interests and concentrative joint ventures) which would result in the creation or strengthening of a dominant position. All concentrations

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in relation to which the combined overall turnover, in Italy, of the companies involved is higher than 387 million or the turnover of the company being acquired is, in Italy, higher than 39 million, must receive a prior authorization from the Antitrust Authority. These thresholds are adjusted every year to take account of inflation. Failure to file prior notification of a concentration to the Antitrust Authority will result in a fine from 1% to 10% of the turnover of the parties involved in the concentration, or higher in the case of fines for violation of a prohibition of a concentration.

Law 287 is administered by the Antitrust Authority which, either on its initiative or following a complaint submitted by any interested party (the Interested Party), has the power to investigate and ascertain compliance with Law 287. When the Antitrust Authority finds prima facie evidence that Law 287 has been violated, the parties involved (including the Interested Party) are notified of the opening of a formal investigation. The party under investigation (the Investigated Party) and the Interested Parties shall then have the right to be heard and to file written arguments with the Antitrust Authority. Pending the investigation, the Antitrust Authority may also require the parties involved and third parties to disclose information or to submit documents that it considers useful for the investigation. In addition, the Antitrust Authority may appoint experts and carry out direct inspections at the Investigated Party's premises in order to examine and seize relevant documents.

If, at the conclusion of the investigation, the Antitrust Authority determines that Law 287 has been violated, it orders the Investigated Party to cure the relevant violation and, in the case of serious violations, imposes fines up to 10% of the turnover of the Investigated Party. Any failure to comply is sanctioned with an additional fine up to 10% of the turnover of the Investigated Party.

With respect to competition matters, the decisions of the Antitrust Authority are considered administrative acts and may be appealed before the Regional Administrative Tribunal (TAR) of Lazio, based in Rome, for violation of law, abuse of power and lack of jurisdiction. The TAR may either reject the appeal or declare the Antitrust Authority's decision null and void. The TAR, upon request of the complainant, may also suspend the enforcement of the decision of the Antitrust Authority. The TAR's judgments may be further appealed before the State Council, whose decision is final.

The Antitrust Authority has no powers other than those indicated above. It may not issue provisional injunctions or impose liquidated damages for abuses of dominant positions. For these remedies, Law 287 confers special jurisdiction to the Court of Appeal that has jurisdiction over the relevant case.

In addition to Law 287, the Maccanico Law confers upon the NRA the power to enforce provisions aimed at ensuring pluralism in the communications sectors, including radio and television broadcasting activities.

Moreover, the competition rules of the EU (EU Competition Law) have a direct effect in Italy. The main principles of EU Competition Law are contained in Articles 81 and 82 of the Treaty of Rome. Article 81 prohibits agreements or concerted practices between undertakings that may affect trade between Member States and has the object or effect of restricting competition within the EU. Article 82 prohibits any abuse of a dominant position within a substantial part of the EU that may affect trade between Member States. These rules are primarily enforced by the European Commission, which cooperates with the national competition authorities, and through the national courts. The Antitrust Authority has the power to apply Article No. 81(1) and Article 82, following its own procedures and imposing, if necessary, the fines provided for under Law 287. In September 1991, general guidelines were published by the European Commission on the application of EU Competition Law in the telecommunications sector. In August 1998, the European Commission published a notice updating the 1991 guidelines. These guidelines outline the EU's approach to common competition issues.

On August 22, 1998, the European Commission published a Communication on the application of the competition rules to access agreements in the telecommunications sector. The purpose of this notice was:

- to set out access principles stemming from EU law in order to create more market certainty;
- to define and clarify the relationship between competition law and sector specific regulation; and
- to explain how competition rules will be applied in a consistent way across the converging sectors. On October 3, 1997, the EU adopted a further communication on the definition of the relevant market for the purpose of EU Competition Law. The aim of this notice is to provide guidance as to how the European Commission applies the concept of relevant product and geographic market in its ongoing enforcement of EU Competition Law.

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In April 1999, the European Commission adopted a White Paper on modernization of the rules implementing Articles 81 and 82 of the EC Treaty, which examined various options for reforming the system and proposed the adoption of fundamentally different enforcement system called a direct applicable exception system. Such system is based on the direct applicability of the exception rule of Article 81.3, implying that the European Commission and national competition authorities and courts would apply Art. 81.3 in all proceedings in which they are called upon to apply Art. 81.1, which is already directly applicable.

On December 16, 2002, the EU Council approved the Regulation No. 01/2003 (OJ L 1 01/04/2003) On the implementation of the rules on competition laid down in articles 81 and 82 of the Treaty . The Council Regulation provides, inter alia, for the abolition of the European Commission's exclusivity in the application of art. 81.3; a system of legal exception and ex post evaluation of the agreements; an effective decentralization of the enforcement of EU competition rules; and the strengthening of the European Commission's investigation powers. This regulation has replaced Regulation 17/62. The new Regulation simplifies the way in which the EC Treaty's antitrust rules are enforced in the European Union. Most importantly, the new Regulation abolishes the practice of notifying business agreements to the European Commission, therefore reducing bureaucracy and legal costs for companies. The simplified system of the new Regulation is designed to facilitate the effective enforcement of the antitrust rules in the EU comprising more than 15 Member States. The new regulation allows national courts and competition authorities to directly apply Article 81(3) without prior involvement of the European Commission.

Under the Regulation, where the trend of trade between Member States, the rigidity of prices or other circumstances suggest that competition may be restricted or distorted within the common market, the European Commission may conduct an inquiry into a particular sector or into a particular type of agreements across various sectors. The European Commission may request the undertakings or associations concerned to supply all the information necessary for giving effect to Arts. 81 and 82 of the Treaty and may carry out any inspections necessary for that purpose.

On December 11, 2001, the European Commission issued a Green paper on the Review of Council Regulation (EEC) No. 4064/89, concerning mergers with community dimensions. The European Commission sought to launch a wide ranging debate on the functioning of the EU merger control regime based on the experience gained during the preceding 10 years.

During 2003, the European Commission published the Best Practices on the conduct of EC merger control proceedings , in order to provide guidance for interested parties on the day-to-day conduct of EC merger control proceedings and foster and build upon a spirit of cooperation and better understanding between DG Competition and the legal and business community. The European Commission found that it was the appropriate time to review the Regulation, to ensure effective, efficient, fair and transparent control of concentrations at the most appropriate level.

On January 20, 2004, the European Commission adopted a new Regulation on the control of concentrations between undertakings. The regulation tackles jurisdictional issues (such as the notion of concentration and the community dimension), substantive issues (such as the concept of dominance) and procedural issues (such as the timing of notifications, the suspension of proceedings, etc.).

On February 5, 2004, the Commission also published Guidelines on horizontal mergers which address, inter alia, the issue of oligopolies and collective dominance.

4.3.9 REGULATION OF THE BRAZILIAN TELECOMMUNICATIONS INDUSTRY

General

Mobile Brazil is subject to comprehensive regulation under the Brazilian General Telecommunications Law, and a comprehensive regulatory framework for the provision of telecommunications services promulgated by Anatel.

Anatel is the regulatory agency for telecommunications under the General Telecommunications Law (LGT Law 9472 from July 16, 1997) and *Regulamento da Agência Nacional de Telecomunicações* (the Anatel Decree No. 2338 of October 7, 1997). Anatel is administratively independent and financially autonomous. Anatel maintains a close relationship with the Ministry of Communications and is required to report its activities to the

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Ministry of Communications. It has authority to propose and to issue regulations that are legally binding on telecommunications service providers. Any proposed regulation or action by Anatel is subject to a period of public comment, which may include public hearings, and may be challenged in Brazilian courts.

Authorizations and Concessions

Licenses to provide telecommunications services are granted either under the public regime, by means of a concession, or the private regime, by means of an authorization. Only certain fixed-line service providers are currently operating under the public regime.

Services provided under the private regime are classified as either providing a service of collective interest or restricted interest. Collective interest private regime services are subject to requirements imposed by Anatel under the applicable authorizations and the General Telecommunications Law. Restricted interest private regime services are subject to fewer requirements than public regime or collective interest private regime services. Under the authorizations, TIM Brasil and its subsidiaries operate under the collective interest private regime.

Obligations of Telecommunications Companies

Beginning in September 2003, TIM Brasil and its subsidiaries became subject to certain quality of service indicators. Since December 2003, TIM Brasil and its subsidiaries have achieved the majority, but not all of the service of quality requirements applicable to PCS service operators. Some of the PCS quality of service indicators are currently difficult to achieve due to, for example, dependence on the performance of third parties and the continuing clarification of some of the quality of service measurements under the PCS rules. In December 2004, Anatel initiated administrative proceedings against certain of TIM Brasil's subsidiaries for non-compliance with certain quality of service obligations under the PCS authorizations in the years 2003 and 2004. TIM Brasil has submitted to Anatel a petition explaining the reasons for non-compliance. TIM Brasil believes that it has since complied with Anatel's quality standards and that customer satisfaction has improved. TIM Brasil cannot predict the outcome of the Anatel proceedings at this time but does not believe that an unfavorable outcome will cause a material adverse effect on TIM Brasil and its subsidiaries business, financial condition and results of operations.

PCS Regulation

In September 2000, Anatel promulgated regulations regarding PCS wireless telecommunications services. The new rules allow companies to provide wireless telecommunications services under PCS authorizations. The PCS authorizations allow new entrants in the Brazilian telecommunications market to compete with existing telecommunications service providers.

Under the PCS regulations, TIM Brasil is generally free to determine the prices charged for its services, subject to certain limitations imposed by Anatel rules and the General Telecommunications Law. TIM Brasil and its subsidiaries have been subject to

such new rate structure since July 2003. TIM Brasil has no available data indicating how this rate structure could adversely affect fee considerations and results of operations of the TIM Brasil group.

According to the new PCS regulations, TIM Brasil is required to adjust its operating processes and agreements to such new rules, including our interconnection agreements, as well as agreements with its customers. By April 2005, substantially all of its interconnection arrangements were covered by agreements that had been amended to reflect the PCS regulations.

Interconnection Regulation

Telecommunications service providers are required to provide interconnection according to the General Interconnection Rules, adopted by Anatel through Resolução 410/05, which replaced Resolução 40/98. The terms and conditions of interconnection are to be negotiated by the parties, within certain guidelines established by Anatel, which indicate that Anatel will not allow anti-competitive practices, in special exercise of subsidies or artificial decrease in price, the unauthorized use of competitors information, the omission of relevant technical and commercial information, prevent abusive demands to enter into interconnection agreements, intentional delay in negotiation, coercion in order to enter into an interconnection agreement, and imposition of conditions

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that lead to the inefficient use of the network or equipment. Even though the rule is that interconnection prices will be freely negotiated by the operators, Anatel may set the price for the interconnection if the operators are unable to reach a consensus or if the prices agreed upon are damaging to competition, at Anatel's discretion. Interconnection agreements must be approved by Anatel before they become effective. Telecommunications service providers must make available public interconnection offers with all information relevant for the establishment of an interconnection (applicable regulation is vague as to the scope of information that must be included in the public interconnection offer), ensuring non-discriminatory treatment of service providers interest in such interconnection.

Significant Market Power

In 2005, Anatel issued specific regulations regarding telecommunications service providers with significant market power. Anatel has indicated that it will establish more stringent regulations for economic groups with significant market power in order to ensure market competition. Anatel will name the economic groups with significant market power. We cannot give assurance that TIM Brasil and certain of its subsidiaries will not be deemed to have significant market power, and thus subject to increased regulatory requirements.

Anatel has not yet adopted rules for determining significant market power in the mobile telecommunications industry nor the increased regulations to which the relevant economic group will be subject. TIM Brasil is only able to refer to the regulations applicable to other telecommunications services for guidance regarding the regulations to which it may become subject. With respect to service providers that offer fixed telephony and leased lines, Anatel has indicated that a service provider will be deemed as holding significant market power if the service provider itself or the economic group to which it belongs is able to exercise significant influence on a relevant market as may be defined by Anatel. No service provider with significant market power has been named by Anatel to date.

Rate Regulation

Under our PCS authorizations, TIM Brasil is allowed to set prices for its service plans, subject to approval by Anatel (homologation process before launching each service plan). Re-adjustment procedures are allowed in a yearly basis timeframe considering declared inflation indexes. Telecom market currently uses the IGP-DI (the *Índice Geral de Preços Disponibilidade Interna*), a general price inflation index in evaluating prices and determining the relevant cap for prices charged in the telecommunications industry. Beginning in 2007, TIM Brasil expects Anatel to begin to evaluate interconnections fees in the telecommunications industry based on a model that would analyze a company's costs based on a hypothetical company's costs and other factors.

The interconnection fees that TIM Brasil is allowed to charge other service providers was subject to a price cap stipulated by Anatel. This price cap has expired and, beginning in 2005, the terms and conditions of the interconnection fees are freely negotiated among the operators, subject to Anatel regulations.

Value-Added Services and Internet Regulation

Value-added services are not considered under Brazilian telecommunications regulations to be telecommunications services, but rather an activity that adds features to a telecommunications service supported by such value-added services. Regulations require all telecommunications service providers to grant network access to any party interested in providing value-added services, on a non-discriminatory basis, unless technically impossible. Telecommunications service providers also are allowed to render value-added services through their own networks. Internet access is considered by Brazilian legislation to be a value-added service, and its providers are not considered to be telecommunications companies. Current regulations allow TIM Brasil or any other interested party to offer Internet connection services through TIM Brasil's network.

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4.4 GLOSSARY OF SELECTED TELECOMMUNICATIONS TERMS

The following explanations are not intended as technical definitions, but to assist the general reader to understand certain terms as used in this Annual Report.

2G (second-generation Mobile System): Second-generation protocols using digital encoding and including GSM, D-AMPS (TDMA) and CDMA. 2G networks are in current use all over Europe and other parts of the world. These protocols support high bit rate voice and limited data communications. 2G networks technology offer auxiliary services such as data, fax and SMS. Most 2G protocols offer different levels of encryption.

3G (third-generation Mobile System): Third-generation wireless service, designed to provide high data speeds, always-on data access, and greater voice capacity.

3G networks technology provide to transfer both voice data services (telephony, messaging) and non-voice data (such as downloading Internet information, exchanging email, and instant messaging). The high data speeds, measured in Mbps, are significantly higher than 2G and, 3G networks technology enable full motion video, high-speed internet access and video-conferencing. 3G technology standards include UMTS, based on WCDMA technology (quite often the two terms are used interchangeably) and CDMA2000.

Access charge: Amount charged per minute by national operators for the use of their network by operators of other networks. Also known as an interconnection charge .

ADSL (Asymmetric Digital Subscriber Line): A modem technology which converts existing twisted-pair telephone lines into access paths for multimedia and high-speed data communications. ADSL can transmit up to 6 Mbps to a subscriber, and up to as 832 Kbps or more in both directions. Such rates expand existing access capacity by a factor of 50 or more without new cabling.

Analog: A transmission or switching which is not digital, e.g., the representation of voice, video or other modulated electrical audio signals not in digital form.

Analog network: A network using analog technology with circuit switching, capable of connecting one user with all the others, but with limited transmission capacity.

ASTN (Automatically Switched Transport Network): Emerging architectural standard for switched intelligent optical network for the management of the automatic signaling and routing of connection, auto-discovery and meshed optical network protection.

ATM (Asynchronous Transfer Mode): A broadband switching technology that permits the use of one network for different kinds of information (e.g., voice, data and video).

Backbone: A primary shared communication path that serves multiple networks and may facilitate communications between different protocols.

Broadband services: Services characterized by a transmission speed of 2 Mbit/s or more. According to international standards, these services are divided into two categories: (i) Interactive services, including videotelephone/videoconferencing (both point-to-point and multipoint); videomonitoring; interconnection of local networks; file transfer; CAD; highspeed fax; e-mail for moving images or mixed documents; broadband videotex; Video on demand; retrieval of sound programs or fixed and moving images; and (ii) Broadcast services, such as sound programs, television programs (including high-definition TV and pay TV) and selective document acquisition.

Broadcast: Simultaneous transmission of information to all nodes and terminal equipment of a network.

BSS (Business Support System): The system used by network operators to manage business operations such as billing, sales management, customer-service management and customer databases. A type of Operations Support System (OSS).

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BWA (Broadband Wireless Access): Technology aimed at providing wireless access to data networks, with high data rates and providing data transmission up to a theoretical limit of 52 Mbit/s downstream and 12 Mbit/s upstream over a single twisted pair of wires. VDSL is capable of supporting high bandwidth applications such as HDTV. From the point of view of connectivity, broadband wireless access is equivalent to broadband wired access, such as ADSL or cable modems. One particular broadband wireless access technology is being standardized by IEEE 802.16 also known as WiMAX.

Carrier: Traditionally, the carrier is the company that makes available the physical lines.

CATV (Cable television): Cable or fiber-based distribution of TV programs.

CDMA (Code Division Multiple Access): A digital wireless technology used in radio communication for transmission between a mobile phone and a radio base station. CDMA was developed by Qualcomm, and commercially introduced in 1995. It enables the simultaneous transmission and reception of several messages, each of which has a coded identity to distinguish it from the other messages.

Cellular: A technique used in mobile radio technology to use the same spectrum of frequencies in one network multiple times. Low power radio transmitters are used to cover a cell (i.e., a limited area) so that the frequencies in use can be reused without interference for other parts of the network.

Channel: The portion of a communications system that connects a source to one or more destinations. Also called circuit, line, link or path.

Closed User Group: A group of telecommunications users that share a longstanding economic interest. This definition has arisen in a regulatory context; it permits the partial liberalization of some telecommunications services.

Coaxial cable: A type of electrical cable in which a central conductor covered by an insulator is then surrounded with a cylindrical conducting sheath whose axis coincides with that of the central conductor, hence the term coaxial.

Corporate Network: A network, which can be a virtual private network, provided by a corporation for its own use and possibly for that of other corporations. The network's features are tailor-made to address the specific needs of the client. It is separate from the network provided by the national telecommunications carrier, but it may be connected to the latter for the use of selected facilities.

CPS (Carrier Pre-selection): Permits a customer to pre-select another operator as an alternative to Telecom Italia without dialing an identifying code.

D-AMPS (Digital-Advanced Mobile Phone Service): Is a digital version of AMPS (Advanced Mobile Phone Service), the original analog standard for cellular telephone phone service in the United States.

Data Network Access Point: Unit of measurement used in the data network business.

DCS 1800 (Digital Communication System): A derivative of the GSM cellular mobile telephone standard. 1800 refers to the frequency used of 1800 MHz. DCS 1800 is the European PCN standard.

Digital: A mode of representing a physical variable such as speech using digits 0 and 1 only. The digits are transmitted in binary form as a series of pulses. Digital networks are rapidly replacing the older analog ones. They allow for higher capacity and higher flexibility through the use of computer-related technology for the transmission and manipulation of telephone calls. Digital systems offer lower noise interference and can incorporate encryption as a protection from external interference.

Digital Terrestrial TV: Digital Terrestrial Television Broadcasting is a new type of broadcasting technology that provides a more effective way of transmitting television services using a digital system instead of the existing analogue system.

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District traffic: Long distance telephone calls within the same area code.

DSL Network (Digital Subscriber Line Network): A network built on existing telephone lines with DSL technology devices which use sophisticated modulation schemes to pack data onto copper wires for connections from a telephone switching station to a home or office.

DVB-H (Digital Video Broadcasting-Handheld): Technical specification for bringing broadcast (TV) services to handheld receivers, including compatible mobile phones and was formally adopted as ETSI standard EN 302 304 in November 2004.

EDGE (Enhanced Data for GSM Evolution): A prototype in the evolution of data communications within existing GSM standards.

ETSI (European Telecommunications Standards Institute): A not-for-profit enterprise whose mission is to produce the telecommunications standards that will be used throughout Europe. Some of the standards developed by the ETSI may be adopted by the European Commission as the technical base for directives or regulations. The ETSI's main task is to remove any possible variation from a global standard and to focus on a defined European-specific set of requirements. The ETSI also ensures that there is interoperability between standards, such as Integrated Services Digital Network (ISDN), Global Systems for Mobile Communications (GSM) and Universal Mobile Telecommunications System (UMTS).

Exchange: See Switch.

Frame Relay: A data transmission service using fast protocols based on direct use of transmission lines.

Gateway: A connection between the LANs and WANs of one or more suppliers. Can also mean the access nodes to international networks of various kinds.

GPRS (General Packet Radio Service): This is the data service for GSM and is the European standard digital cellular service.

GPS (Global Positioning System): A constellation of satellites, orbiting the Earth two times a day, that is able to pinpoint precisely the location of a certain object on Earth.

GRX (GPRS Roaming eXchange for Mobile Operators): The GRX service allows Mobile Operators to interconnect GPRS networks around the world and offer global GPRS roaming coverage.

GSM (Global System for Mobile Communications): A standard for mobile cellular telephony used in Europe, Asia, South Africa and Australia, based on digital transmission and cellular network architecture with roaming.

GSM TIM Card: A prepaid, rechargeable card which permits the TIM mobile customer to make outgoing calls up to the limit of the card and receive an unlimited number of calls.

HDSL (High-bit-rate Digital Subscriber Line): Technology which allows the provision of local loop circuits at higher speeds and lower cost than through conventional means.

HDSPA (High-speed Downlink Packet Access): New mobile telephony protocol, is an evolution of the UMTS standard, designed to increase the available data rate (downlink) by a factor of 5 or more. It defines a new W-CDMA channel that operates in a different way from basic UMTS/W-CDMA channels, but is only used for downlink communication to the mobile.

ICT (Information and communication(s) technology): Broad area concerned with information technology, telecommunications networking and services and other aspects of managing and processing information, especially in large organizations.

IEEE (Institute of Electrical and Electronics Engineers): An organization of engineers, scientists and students involved in electrical, electronics and related fields. IEEE also functions as a publishing house and standards body.

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IMSS/MSEM (Italtel Multi Service Solution/Multi Service Element Manager): It is a proprietary platform for the management of the whole network. Refer to a software switch that is compatible with many protocol type for IP communication and network interworking as SIP, H323, MGCP and H248. The supplier is ITALTEL.

IN (Intelligent Network): Network architecture that centralizes processing of calls and billing information for calls.

Interactive: Allowing the user to change some aspect of the program.

Internet: The world's best-known data network. Initially used by the U.S. Department of Defense, the Internet now provides an interface for networks based on different technologies (LANs, WANs, data networks, etc.), but which use the TCP/IP protocol platform.

Internet Protocol TV or IPTV: The service provides the distribution of television channels over Internet connections using the IP protocol. More than just duplicating a distribution means, IPTV enables interactive services so that the viewer can interact with the show as it is broadcast.

IP (Internet Protocol): A standard describing the software that keeps track of the Internet's addresses for different nodes, routes outgoing messages and recognizes incoming messages.

IP/MPLS (Internet Protocol/Multi Protocol Labeling Switching): A packet switching protocol to optimize network behaviors of mapping Layer3 (IP) end-to-end data flow to Layer2 traffic between adjacent network nodes.

ISDN (Integrated Services Digital Network): A system in which several services (e.g., speech and data) may be simultaneously transmitted end to end in digital form.

ISPs (Internet Service Provider): A vendor who provides access to the Internet and World Wide Web.

ITU (International Telecommunication Union): The worldwide policy, spectrum regulation and standardization body in telecommunications operating under the auspices of the United Nations.

LAN (Local Area Network): A private network that covers a local geographic area and provides public telecommunications services as well as interconnection between personal computers.

MAS (Metro Access System): A network element based on CWDM (Course Wavelength Division Multiplexing) technology.

MGCP (Media Gateway Control Protocol): An Internet Engineering Task Force (IETF) signaling protocol proposal allowing a bridge between classic telephone networks and Internet (i.e., IP-based) infrastructures.

MEMS (Micro-Electro-Mechanical Systems): MEMS are miniaturized devices ranging in size from a few micrometers to a few millimeters, which execute one or more monitoring, processing or actuation functions by deploying a combination of electronic, mechanical, optical, chemical or biological components integrated on a usually silicon hybrid circuit.

MMS (Mobile Multimedia Services): Represent an evolution of the SMS and the EMS service using various mono-medial elements (text, design, photos, video-clips and audio), which are synchronized and combined allowing them to be packed together and sent to GSM-GPRS platforms.

Modem: Modulator/Demodulator. A device that modulates digital data to allow their transmission on analog channels, generally consisting of telephone lines.

MPLS (Multi Protocol Label Switching): A packet switching protocol to optimize network behaviors of mapping Layer3 end-to-end data flow to Layer2 traffic between adjacent network nodes.

MS SPRING: A form of traffic protection mechanism for the equipment.

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MSP: The name of a general purpose programmable switch made by Redcom Laboratories.

Multimedia: A service involving two or more communications media (e.g., voice, video, text, etc.) and hybrid products created through their interaction.

Network: An interconnected collection of elements. In a telephone network, these consist of switches connected to each other and to customer equipment. The transmission equipment may be based on fibre optic or metallic cable or point to point radio connections.

NGN (Non-Geographic Number): The non-geographic numbers are unique as they are by definition not associated with any particular geographic location (e.g. premium rate services, toll free, directory assistance services).

NNI (Network Node Interface): The interface between two public network pieces of equipment.

NNI Agreements (Network Node Interface Agreements): Contractual agreements for the interface between two public network pieces of equipment.

Node: Topological network junction, commonly a switching center or station.

OLOs (Other Licensed Operators): Companies other than the incumbent operator which operate telecommunications systems in a national market.

ONP (Open Network Provision): Principles and conditions laid down by the EU for access to and usage of public telecommunications networks and services. A network architecture that permits telecommunications services to be offered on facilities of public operators and for equipment to be connected to such networks.

Optical fiber: A transmission medium which permits extremely high capacities. It consists of a thin strand of glass that provides a pathway along which waves of light can travel for telecommunications purposes.

OSS (Operations Support System): Methods and procedures (whether mechanized or not) which directly support the daily operation of the telecommunications infrastructure.

Outsourcing: Hiring outsiders to perform various telecommunications services, which may include planning, construction, or hosting of a network or specific equipment belonging to a company, and, ultimately, the management of entire telecommunications systems. Value-added applications may also be provided in various sectors.

PABX (Private Automatic Branch Exchange): Telephone switchboard for private use, but linked to the national telephone network.

Packet-Switched Services: Data services based on parceling or breaking the data stream into packets and switching the individual packets. Information transmitted (whether voice or data) is segmented into cells of a standardized length, which are then transmitted independently of one another, allowing maximization of available capacity and usage of a single transmission path for multiple communications. The cells are then reassembled upon reaching their destination.

Pay-Per-View or PPV: A system by which the viewer pays to see a single program (such as a sporting event, film or concert) at the moment at which it is transmitted or broadcast.

Pay TV: Paid-for TV channels. To receive Pay TV or Pay-Per-View programs, a decoder must be connected to the television set, and a conditional access system.

PCN (Personal Communications Network): PCN is a cellular telephony network designed to have the high capacity required to support a mass market service.

PCS: Personal communications services.

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PDA (Personal Digital Assistant): A handheld computer with a memory size up to several megabytes and a touch-sensitive screen, often using a stylus to input data. The PDA is mainly used for calendar, address book and memoranda functions, but can incorporate advanced office or multimedia functions such as voice calls, messaging, video, mp3 player, etc..

Penetration: The measurement of the take-up of services. As of any date, the penetration is calculated by dividing the number of subscribers by the population to which the service is available and multiplying the quotient by 100.

Platform: The total input, including hardware, software, operating equipment and procedures, for producing (production platform) or managing (management platform) a particular service (service platform).

POTS (Plain Old Telephone Service): Refers to the basic telephony service (homes use) supplying standard, single-line telephones, fixed-line services and access to public voice telephony network. In contrast, telephone services based on digital communications lines, such as ISDN, are not POTS. The main distinctions between POTS and non-POTS services are speed and bandwidth. POTS is generally restricted to about 52 Kbps.

PSTN (Public Switched Telephone Network): The public telephone network delivering the basic telephone service and, in certain circumstances, more advanced services.

Roaming: A function that enables wireless subscribers to use the service on networks of operators other than the one with which they signed their initial contract.

RoF (Radio over Fiber): A technology to feed antennas with digital/analogue signals over optical fiber.

Satellite services: Satellites are used, among other things, for links with countries that cannot be reached by cable or as an alternative to cable and to form closed user networks.

SDH Standard (Synchronous Digital Hierarchy): The European standard for high-speed digital transmission.

SDSL (Symmetrical Digital Subscriber Line): Also known as HDSL.

Service Provider: The party that provides end users and content providers with a range of services, including a proprietary, exclusive or third-party service center.

SGT (Transit exchange interconnection level for telephone traffic): Transit Exchange for telephone traffic carriage, routing and transmission.

SGU (Local exchange interconnection level for telephone traffic): Local Exchange for telephone traffic carriage, routing and transmission.

SME: The small- and medium-size enterprise market which consists of businesses having between 3 and 50 employees.

SNCP: A form of traffic protection mechanism for the equipment.

SOHO: The small office/home office market which consists of businesses that use telephone lines to connect to the Internet, as opposed to dedicated lines, and is made up of small businesses, generally with one or two employees, and businesses conducted out of the home.

SPP (Service Provider Portability): Allows an end user to retain the same directory number after changing from one service provider to another.

Switch: These are used to set up and route telephone calls either to the number called or to the next switch among the path. They may also record information for billing and control purposes.

Switched Transit Traffic: Calls placed between two other countries that are routed through the Italian fixed network.

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Synchronous: Type of data transmission in which there is permanent synchronization between the transmitter and the receiver.

TACS (Total Access Communication System): An analog cellular network using the 900 MHz band based on a European standard also used in the UK, Ireland, Austria and Spain. Features include handover and available add-on services include answering, call notification, call transfer, differentiation of business and private calls, authorization code for outgoing international calls and itemized billing.

TDMA (Time Division Multiple Access): A technology for digital transmission of radio signals between, for example, a mobile phone and a radio base station. TDMA breaks signals into sequential pieces of defined length, places each piece into an information conduit at specific intervals and then reconstructs the pieces at the end of the conduit.

UMA (Unlicensed Mobile Access): Technology that provides access to mobile services over unlicensed spectrum technologies, such as Bluetooth and IEEE 802.11 b/g. By deploying UMA technology, service providers can enable subscribers to roam and handover between cellular networks and public and private unlicensed wireless networks using dual-mode mobile handsets.

UMTS (Universal Mobile Telecommunication System): Third generation mobile communication system.

Universal service: The obligation to supply basic service to all users throughout the national territory at reasonable prices.

VAS (Value Added Services): Value Added Services provide a higher level of functionality than the basic transmission services offered by a telecommunications network for the transfer of information among its terminals, which include wired or wireless switched-circuit analog voice communications; direct unrestricted digital point-to-point service at 9,600 bit/s; packet switching (virtual call); direct broadband analog transmission of TV signals, and supplementary services, such as closed user groups; call waiting; collect calls; call forwarding, and identification of number called. Value Added Services performed by the network, the terminals or the specialized centers include message handling services (MHS) (which can be used, among other things, for commercial documents in predetermined formats); electronic directories listing users, network addressees and terminals; e-mail; fax; teletex; videotex and videotelephone. Value Added Services could include also value added voice telephony services such as Freephone or Premium Rate Services.

VAN (Value-added Network): A type of public network that leases basic transmission facilities from a common carrier, adds features that enhance the service and provides the improved communications capability to end users. Automatic alternate routing network management and error correction are examples of the value added.

VDSL (Very-high-data-rate Digital Subscriber Line): One of four DSL technologies (very high bit-rate DSL) providing data transmission up to a theoretical limit of 52 Mbit/s downstream and 12 Mbit/s upstream over a single twisted pair of wires. VDSL is capable of supporting high bandwidth applications such as HDTV. The higher limit of data rate of VDSL is limited by the distance from the exchange.

Videotex: A service pursuant to an ITU standard, permitting remote access to a database by telephone.

VoIP (Voice over ip): Transmission of voice communications over Internet Protocol (IP) data networks, such as IP-based LANs, intranets or the Internet. Many carriers offer integrated services such as voice and data over a single pipe.

VPN (Virtual Private Network): A network designed for a business or government agency, using the infrastructures of a carrier and providing customized services, and which operates in such a manner as to appear dedicated to the user thereof.

WAN (Wide Area Network): A private network that covers a wide geographic area using public telecommunications services.

WAP (Wireless Application Protocol): A technology which allows access to the Internet using mobile sets, even without the use of a computer.

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Item 4. Information On The Telecom Italia Group

Glossary Of Selected Telecommunications Terms

WI FI: A service for wireless Internet connection and high speed access.

WLL (Wireless Local Loop): The means of configuring a local loop without the use of wiring.

XSDL ((generic) Digital Subscriber Line): A generic term for DSL equipment, services and technologies which provide extremely high bandwidth over the twisted-pair lines that run from a phone company's central office to a home or office.

Table of Contents**Item 4. Information On The Telecom Italia Group****Description Of Property, Plants And Equipment****4.5 DESCRIPTION OF PROPERTY, PLANTS AND EQUIPMENT****General**

As of December 31, 2005, the Telecom Italia Group owned approximately 5,550 buildings located throughout Italy. Specialized buildings for telecommunications services account for the majority of properties both in number and book value. They house mainly exchange equipment and transmission equipment, and are used as part of our continuing telecommunications operations. General purpose properties consist chiefly of offices, depots and computer centers.

The principal categories of our equipment are exchanges and transmission equipment, cable networks, base stations for cellular networks and equipment for radio communications, most of which are located throughout Italy. We also have numerous computer installations which are primarily located at the headquarters of our significant subsidiaries.

As of December 31, 2005, property, plants and equipment owned and leased are detailed as follows:

	As of December 31, 2004				As of December 31, 2005			
	Owned	Leased	Total property, plants and equipment	% of total property, plants and equipment	Owned	Leased	Total property, plants and equipment	% of total property, plants and equipment
(millions of Euro, except percentages)								
Land	224	8	232	1.2	155		155	0.9
Civil and industrial buildings	1,458	1,561	3,019	15.5	972	1,477	2,449	13.6
Plant and equipment	14,150	1	14,151	72.5	12,907	1	12,908	71.5
Manufacturing and distribution equipment	62		62	0.3	72		72	0.4
Aircrafts and ships	55	18	73	0.4	46	14	60	0.3
Other	962	65	1,027	5.3	1,174	71	1,245	6.9
Construction in progress and advances to suppliers	942		942	4.8	1,117	35	1,152	6.4
Total	17,853	1,653	19,506	100.0	16,443	1,598	18,041	100.0

As of December 31, 2005, we did not have liens, mortgages and pledges on real property owned.

Real Estate Transactions

An important element of our restructuring plan was to realize value on our extensive real estate portfolio.

In November 2000, we established a partnership with Beni Stabili, a leading Italian real estate operator, and Lehman Brothers to manage a significant portion of our real estate portfolio.

We contributed a going concern including an important portion of our real estate portfolio to IM.SER and subsequently sold 45% of this company to Beni Stabili and 15% to Lehman Brothers.

The real estate portfolio originally held by IM.SER consisted of 581 properties, totaling 3.7 million square meters and was composed of two parts, the Real Estate Investment Portfolio and the Real Estate Trading Portfolio :

- Real Estate Investment Portfolio , consisting of 386 properties totaling approximately 2.4 million square meters, located throughout Italy. All the properties, including buildings that contain telecommunications equipment, were leased to Old Telecom Italia at the end of 2000 under long-term lease contracts (21 plus 6 years) at market rates; and
- Real Estate Trading Portfolio , consisting of 195 properties totaling approximately 1.3 million square meters, located throughout Italy. Of these properties, the majority have been leased at market rates to Old Telecom Italia under contracts allowing for early termination by Telecom Italia.

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Item 4. Information On The Telecom Italia Group

Description Of Property, Plants And Equipment

In May 2001, IM.SER contributed its Real Estate Trading Portfolio to Telemaco Immobiliare, a newly formed company. Following such contribution, IM.SER sold the shares of Telemaco Immobiliare to its shareholders. The shareholders of Telemaco Immobiliare at that time were Beni Stabili with a 45% stake, Telecom Italia with a 40% stake and Lehman Brothers with a 15% stake.

On May 16, 2001, Beni Stabili exercised an option to buy the Lehman Brothers stake in IM.SER, resulting in Beni Stabili holding a 60% stake in IM.SER and Old Telecom Italia a 40% stake.

Since 2002 certain additional real estate related transactions were completed:

Tiglio Project

Pursuant to a framework agreement signed in May 2002, among the Pirelli Group, Olivetti-Telecom Italia Group and The Morgan Stanley Real Estate Funds (through MSMC Italy Holding B.V. and POPOY Holding B.V.), certain real estate properties as well as the entities that provide real estate services to the same companies or to their subsidiaries were transferred to two new vehicle companies set up for this purpose (Tiglio I S.r.l. and Tiglio II S.r.l.).

Among the preliminary transactions for the concentration of the real estate assets in Tiglio I and Tiglio II, on October 24, 2002, the non-proportional partial spin-off of IM.SER (60% Beni Stabili and 40% Telecom Italia) was effected by which the real estate assets were contributed to the company IM SER 60 (98% Beni Stabili group and 2% Telecom Italia) and to the company EMSA Immobiliare (100% controlled by Telecom Italia) in proportion to the stakes held in IM.SER, respectively, by Beni Stabili and Telecom Italia.

Following this transaction, which came after the completion of the securitization of IM SER 60's debt and acquisition of certain tangible asset by companies in the Seat Pagine Gialle group, EMSA Immobiliare had a portfolio of 169 real estate properties.

On October 29, 2002, the first stage of the Tiglio Project was concluded, through:

- the subscription by Old Telecom Italia, simultaneously with all the other participants, to a capital increase by Tiglio I for cash, with the resulting stake in the company equaling 36.85% (in addition, at Old Telecom Italia Group level, to the 2.1% subscribed to by Seat Pagine Gialle), in proportion to the value of the assets transferred by Old Telecom Italia (and by Seat Pagine Gialle) to Tiglio I to the total assets that were taken over by Tiglio I;
- the subscription to a capital increase by Tiglio II paid for in kind by the contribution of Old Telecom Italia's Asset Management business segment with resulting stake in the company equaling 49.47%;

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- the sale directly and through the subsidiary Saiat of the investment in Telimm S.r.l. to the company MSMC Immobiliare Holding (entirely controlled by Tiglio I).

With reference to the part of the Tiglio Project regarding the optimization of the service activities, in November 2002, Telecom Italia sold its Property Management , Project Management and Agency businesses to the Pirelli & C. Real Estate group.

The above mentioned transactions gave rise to a total gross capital gain for the Telecom Italia Group of 234 million.

Finally, as agreed between the parties, December 24, 2002, marked the completion of the merger by absorption, in Tiglio I and Tiglio II, of the real estate investment holdings owned by them falling under the Tiglio Project and already 100% controlled, directly or indirectly; resulting in the optimization of the corporate structure of the two companies, in view of the successive actions to leverage the assets on the market.

In particular, the second stage of the Tiglio Project consisted of the change of asset ownership, through transfers to real estate funds, or through completion of certain other transfers. The real property has been divided into several categories (office, industrial portfolio, trading portfolio, etc.), in order to optimize Tiglio I and Tiglio II shareholders profit, and also into take account the real estate funds market features.

Table of Contents**Item 4. Information On The Telecom Italia Group****Description Of Property, Plants And Equipment**

Under the second stage of the Tiglio project, 2004 marked the successful placement on the market of the following real estate funds:

- **TECLA FONDO UFFICI** placement closed on March 1, 2004. The Fund consisted of a contribution on the part of Tiglio I (45.70%-owned by Telecom Italia) of a real estate portfolio including 65 properties for a total market value of approximately 926 million, to which a 15% discount was applied by virtue of their transfer en masse, in addition to a contribution of 25 million in cash. The total offer, net of indebtedness equal to 60% of the value contributed, amounted to 288 million, of which 10% was kept by Tiglio I, 2% was subscribed by Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A. as manager of the fund, while the remaining 88% was entirely placed on the market.
- **CLOE FONDO UFFICI** placed on the market on June 29, 2004. The Fund consisted of 39 properties contributed by Tiglio I for a market value equal to approximately 877 million, to which a 15% discount was applied by virtue of their transfer en masse. The total offer, net of a financial indebtedness equal to 60% of the value contributed, amounted to approximately 298 million, of which 5% was subscribed by Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A. as manager of the fund, while the remaining 95% was entirely with Italian investors (approximately 70%) and with foreign investors (approximately 30%).
- **OLINDA FONDO SHOPS** placement offered to both qualified investors and the public closed on December 6, 2004. The Fund was officially listed on December 9, 2004. The company Tiglio II contributed three properties which did not originate from and were not used by the Telecom Italia Group. A total of 42 properties were contributed to the Fund, all of which have a commercial use or can be converted to such use, for a market value of over 562 million. The offer also called for inflows of financial resources earmarked for the purchase of two entertainment centers which took place in December 2004. After these purchases, the Olinda Fund consists of 44 properties with market value of approximately 742 million. The value of the Fund is approximately 261 million.
- **CLARICE LIGHT INDUSTRIAL** placement with qualified investors on December 16, 2004. The Fund consisted of 27 properties transferred by Tiglio I and 43 properties transferred by Tiglio II, for a total market value of 221 million, to which a 9% discount was applied by virtue of their transfer en masse. The contribution value was thus equal to 201 million and the value of the fund, after taking into account financial indebtedness of approximately 55% of the contribution value, was approximately 90 million. The Fund was entirely placed with European investors.
- **BERENICE FONDO UFFICI** placement closed on July 14, 2005. The Fund consisted of 54 properties transferred by five private parties, including Tiglio I (8 buildings) and Tiglio II (37 buildings), for a total market value of 860 million, to which a 13% discount was applied by virtue of their transfer en masse. The contribution value was thus equal to 750 million and the value of the fund, after taking into account financial indebtedness, was approximately 300 million. The Fund was entirely placed with Italian and European investors.

Subsequent to these transactions:

- in 2004, Tiglio I and Tiglio II proceeded to distribute cash to the shareholders in the form of a reimbursement of capital (additional paid-in capital) and the repayment of loans. For the Telecom Italia Group, total receipts were approximately 104 million, of which 79 million was from Tiglio I and 25 million from Tiglio II;
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in September 2005, Tiglio I and Tiglio II proceeded to distribute cash to the shareholders in the form of a reimbursement of capital (additional paid-in capital) for 29.7 million and 33.1 million to Telecom Italia S.p.A., respectively. Furthermore, Tiglio II, resolved to pay dividends and Telecom Italia S.p.A. received 11.4 million.

Magnum Project

As part of the activities to reorganize the physical space occupied by network equipment to gradually free part of the buildings used for such equipment, the Board of Directors of Telecom Italia S.p.A. approved the sale of more than 1,300 properties for a total amount of approximately 1 billion. Accordingly, on December 1, 2005, Telecom Italia S.p.A. transferred a first group of 867 properties for a value of 698 million to the company Olivetti Multiservices (**OMS**) and signed the related lease contracts.

Table of Contents**Item 4. Information On The Telecom Italia Group****Description Of Property, Plants And Equipment**

During December 2005, Telecom Italia S.p.A. and OMS also formalized two Framework Agreements (described below) aimed at transferring the assets to closed-end real estate investment funds:

- on December 23, 2005, Telecom Italia S.p.A. and OMS signed, with Pirelli & C. Real Estate SGR S.p.A. and the companies Doria S.r.l., Colombo S.r.l. and Vespucci S.r.l. (stakes in these companies are held by The Morgan Stanley Real Estate Funds (65%) and by Pirelli & C. Real Estate SGR S.p.A. (35%)), the framework agreement for the contribution of real estate assets having a total value of approximately 790 million to the fund Pirelli RE Fund Raissa Closed-end real estate investment fund . As part of this Framework Agreement, on December 28, 2005, OMS transferred to the Raissa fund a first group of 561 properties for a transfer value of 486 million, in addition to financial debt equal to 286 million assumed beforehand by OMS and transferred to the fund itself. The majority of the shares of the Raissa fund was placed with institutional investors owned by The Morgan Stanley Real Estate Funds . Pirelli & C. Real Estate SGR S.p.A. has a 35% investment in the Raissa fund under a joint venture with the same Funds. The transaction generated a gross capital gain for the Group at consolidated level of 186 million, and a positive impact on the consolidated financial debt of the Group of 392 million before taxes;
- on December 23, 2005, Telecom Italia S.p.A. and OMS signed, with Pirelli & C. Real Estate S.p.A. and Spazio Industriale II BV (a company controlled by Cypress Grove International Funds), the framework agreement for the contribution of real estate assets having a total value of 300 million to the fund Spazio Industriale Closed-end real estate investment fund for speculation . As part of this Framework Agreement, on December 29, 2005, OMS transferred to the Spazio Industriale fund a first group of 246 properties for a transfer value of 177 million, in addition to financial debt equal to 152 million assumed beforehand by OMS and transferred to the fund itself. The majority of the shares of the Spazio Industriale fund was placed with institutional investors owned by Cypress Grove International Funds. Pirelli RE has a 35% investment in the Spazio Industriale fund under a joint venture with the same Funds. The transaction generated a gross capital gain for the Group at consolidated level of 83 million, and a positive impact on the consolidated financial debt of the Group of 176 million before taxes.

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Item 4A. Unresolved Staff Comments

Item 4A. UNRESOLVED STAFF COMMENTS

None.

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Item 5. Operating And Financial Review And Prospects

General Factors Affecting The Telecom Italia Group s Business

Item 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion should be read in conjunction with the Consolidated Financial Statements included elsewhere in this Annual Report. Such financial statements have been prepared in accordance with IFRS, which differ in certain material respects from U.S. GAAP. For a discussion of the principal differences between IFRS and U.S. GAAP as they relate to Telecom Italia, see Note 43 Reconciliation of IFRS as adopted by the EU to U.S. GAAP of the Notes to the Consolidated Financial Statements included elsewhere herein.

5.1 GENERAL FACTORS AFFECTING THE TELECOM ITALIA GROUP S BUSINESS

5.1.1 THE ITALIAN MARKET FOR TELECOMMUNICATIONS SERVICES

In 2005, based on external sources and internal estimates, the Italian telecommunications carrier services market grew by 5%. As a whole, the market has shown:

- resiliency of spending versus the economic cycle in Italy; and
- steady growth in consumption patterns.

Italy is one of the European countries with both the highest mobile penetration rate and highest absolute number of subscribers. Italy is a leader among European countries in terms of availability and spread of third generation mobile services.

Over the next three years, the total Italian telecommunications (**TLC**) retail market is expected to grow by around 2% to 3% annually (Compound Average Growth Rate (**CAGR**) 2005-2008) according to our estimates. As in recent years, the growth in demand for telecommunications carrier services is expected to be driven primarily by the development of Broadband and Fixed Data services and by mobile telephone services.

In the Italian Wireline Retail market:

- voice traffic value as a whole is in a process of continuous reduction due to fixed to mobile migration and to reduction in tariffs relating to mobile termination, although in the coming years the introduction of flat offers (on traditional POTS and innovative VoIP technologies) should partially compensate these migration dynamics;

- the Internet segment continues to grow driven by broadband development that enables dual and triple play services;
- the Fixed Data segment, characterized by continued migration from traditional to broadband data transmission, continues to grow driven by the development of ICT and data solutions (such as application services and infrastructure services).

In the Italian Wireless Retail market:

- the penetration of mobile services continues to grow due to:

mobile voice traffic growth, driven by fixed to mobile substitution;

value added services growth (such as short messages, multimedia messages, browsing, contents and interactive services) enabled by the increasing penetration of UMTS and innovative handsets and the development of mobile broadband;

- the handsets market is expected to grow slightly, but is now a substitution market from GSM/GPRS handsets to innovative UMTS/HSDPA/DVBH handsets.

5.1.2 COMPETITION

Competition

We face domestic competition in all of our businesses. See Item 4. Information on the Telecom Italia Group 4.1 Business 4.1.8 Updated Strategy and Item 4. Information on the Telecom Italia Group 4.2 Business Units 4.2.6 Competition .

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Item 5. Operating And Financial Review And Prospects

General Factors Affecting The Telecom Italia Group s Business

The total telecoms market continues to grow and will be transformed by the introduction of innovative technologies, platforms and services. Convergent services will be one of the main value propositions for business and high-end consumer customers.

Competition remains a significant factor in how our businesses develop. Competitive pressure seen during 2005 in the Italian market is expected to continue in 2006 and to be reflected in:

- further development of unbundling of the local loop and shared access. Full LLU reached approximately 1,117,000 lines handed over to OLOs in 2005;
- further pressure on tariffs (both fixed and mobile);
- in the fixed line business introduction of flat offers on traditional POTS and innovative VoIP technologies;
- further development of Broadband as reference access solution both in wireline and mobile for internet and data services;
- development of consumer and business value added and content services, including triple play offers; and
- aggressive marketing strategies implemented by some mobile competitors.

5.1.3 REGULATORY ENVIRONMENT

For details please see Item 4. Information on the Telecom Italia Group 4.3 Regulation .

5.1.4 TARIFF REBALANCING

For details please see Item 4. Information on the Telecom Italia Group 4.3.6 Tariff and Pricing Policy .

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Item 5. Operating And Financial Review And Prospects

Significant Trends Impacting Our Core Businesses

5.2 SIGNIFICANT TRENDS IMPACTING OUR CORE BUSINESSES

As described above under 5.1 General Factors Affecting the Telecom Italia Group's Business, management has identified the following key trends that have, and will continue to have, an impact in our two main business areas.

- Convergence of services, such as fixed and mobile voice bundled offers, dual mode access (UMA), integrated (fixed and mobile) access to messaging and content.
- Achievement of synergies from fixed/mobile integration.

In addition, other key trends should continue to have a significant impact:

Wireline

- Continuing defense of core traffic and access businesses with stabilization of traffic market share.
- Strong development of new value added services (Voice VAS and Web Services) content and handsets (Aladino family and Videophone) contributing to a stabilization in revenues.
- Strong growth of Italian broadband market with significant increase of the Wireline Broadband access portfolio.
- Consolidation of the European broadband project with growth of revenues and customer base in selected European countries, including France and Germany.

Mobile

- Continuing strong competition in the Italian market.
- Stabilization/Growth of Market Share.
- Significant growth in value added services driven by the introduction of new technologies/new handsets and by a higher customer demand.

- Profitable growth in the Brazilian market.

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Item 5. Operating And Financial Review And Prospects

Critical Accounting Policies And Estimates

5.3 CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations is based upon our Consolidated Financial Statements, which have been prepared in accordance with IFRS and which, as described in Note 43-Reconciliation of IFRS as adopted by the EU to U.S. GAAP of the Notes to the Consolidated Financial Statements included elsewhere herein, differ in certain material respects from U.S. GAAP. Our reported financial condition and results of operations as reported under IFRS and in our reconciled U.S. GAAP financial information are based on the application of the accounting methods which involve the use of assumptions and estimates that underly the preparation of our financial statements. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily available. Actual results may differ from these estimates under different assumptions or conditions.

Since our selection and application of accounting policies involve judgments and other assumptions affecting the application of those policies, reported results are sensitive to changes in conditions or assumptions of management and these are factors to be considered when reading our Consolidated Financial Statements. We believe the critical accounting policies described below involve the most significant assumptions and estimates used in the preparation of our Consolidated Financial Statements under IFRS and in our reconciled U.S. GAAP information.

5.3.1 REVENUE RECOGNITION

Revenues are recognized to the extent that it is probable that the economic benefits will flow to the Group and the revenues can be reliably measured. Revenues are stated net of discounts, allowances, and returns. Traffic revenues from interconnections and roaming are reported gross of the amounts due to other TLC operators.

In particular, our primary revenue streams consist of fixed line telecommunication services, mobile telecommunication services, the sale of products including primarily telecommunication (both fixed and mobile) equipment and office products, and Internet access and related services.

Revenues related to fixed line and mobile telecommunication services, principally network access, long distance calls, local and wireless airtime usage, are recognized when the services are provided based on the actual minutes of traffic provided and the contracted fee schedule with the customer.

Revenues from the activation of telephone services, from the recharge of prepaid cards, as well as the related costs, are deferred over the expected duration of the relationship with the customer (principally 8 years for retail customers and 3 years for wholesale customers). The estimate of the duration of the customer relationship is based on historical turnover analysis. Revision of such estimates may lead to differences in the amount and timing of the recognition of revenues and expenses.

Furthermore, we have multiple element arrangements mainly in fixed and mobile business segments.

As allowed by IAS 8 (*Accounting Policies Changes in Accounting Estimates and Errors*), paragraph 12, to account for multiple element arrangements, we have adopted the provisions of the Emerging Issues Task Force Issue No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables* (EITF 00-21) for multiple-element revenue arrangements entered into after December 31, 2003. EITF 00-21 requires that arrangements involving the delivery of bundled products or services be separated into individual component deliverables, each with its own separate earnings process. Revenue relating to the bundled contract is allocated among the different deliverables, based on their relative fair values (the relative fair value of each of the component deliverables to the aggregated relative fair value of the bundled deliverables). The determination of fair values in the fixed and mobile business is complex, because some of the components are price-sensitive and, thus, volatile in a competitive marketplace. Revisions to our estimates of these relative fair values may significantly affect the allocation of sales values among the different deliverables, affecting our future operating results.

5.3.2 ALLOWANCE FOR DOUBTFUL ACCOUNTS

Management maintains an allowance for doubtful accounts to account for estimated losses resulting from the inability of our customers to make required payments. Management bases its estimates on the aging of our

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Item 5. Operating And Financial Review And Prospects

Critical Accounting Policies And Estimates

accounts receivable balances and our historical write-off experience with similar receivables, customer credit-worthiness and changes in our customer payment history when evaluating the adequacy of our allowance for doubtful accounts. If the financial condition of our customers were to deteriorate, our actual write-offs might be higher than we estimate.

5.3.3 ACCOUNTING FOR TANGIBLE AND INTANGIBLE NON-CURRENT ASSETS

Accounting for tangible and intangible non-current assets involves the use of estimates for determining fair value at the acquisition date in the case of assets acquired in a business combination. The expected useful lives of assets with a finite life must be estimated. The determination of the fair values of assets, as well as the useful lives of the assets is based on management's judgment. Changes in the economic conditions of the markets in which we operate, technology and competitive forces could significantly affect the estimated useful lives of these assets and may lead to a difference in the timing and amount of depreciation and amortization expense.

5.3.4 ACQUISITION ACCOUNTING, GOODWILL AND PURCHASE PRICE ALLOCATION

We have entered into certain acquisitions and in the future may make further acquisitions. The calculation of the purchase price, and the subsequent allocation of that purchase price to the fair value of the assets acquired and liabilities assumed, is critical due to the long term impact on the statement of operations.

Under IFRS and U.S. GAAP, we are required to perform a purchase price allocation and, consequently, as part of that allocation, all consideration, including the fair value of exchanged shares, shall be valued. When equity instruments are issued as part of the consideration, under IFRS we measure them at their fair value as of the date of exchange whereas under U.S. GAAP we measure them by taking into account the market price for a reasonable period before and after the date the terms of the acquisition are agreed to and announced.

The purchase price is then allocated to the fair value of the assets acquired and liabilities assumed.

The purchase price allocation requires that all assets, liabilities and contingent liabilities be valued and that significant estimates be made. A change in any of these estimates or judgments could change the amount to be allocated to a particular intangible or tangible asset. The resulting change in the purchase price allocation to non-goodwill assets or liabilities has a direct impact on the final amount of the purchase price that cannot be allocated to a particular asset (i.e., goodwill).

If actual results differ from these estimates, or we adjust the estimated useful economic lives in future periods, operating results could be significantly affected by these estimates and judgments which involve:

- the definition of the purchase price;
- the identification of the assets acquired and liabilities assumed in the acquisition;
- the valuation of these assets and liabilities in the purchase price allocation; and
- the assessment of whether selected assets have a finite or indefinite life.

These could have a significant impact on both the level of total goodwill and ultimately on the statement of operations.

Furthermore, when we acquire additional stock held by minority shareholders, under IFRS, in the absence of a specific Standard or Interpretation, the excess of the acquisition cost over the carrying value of net assets acquired is recognized as goodwill (Parent entity extension method). Under U.S. GAAP, such acquisitions are accounted for under the purchase method and, consequently, goodwill is calculated as the difference between the consideration paid and the proportionate share of the fair value of net assets acquired at the date of acquisition.

5.3.5 IMPAIRMENT OF ASSETS

The determination of impairments of tangible and intangible assets involves the use of estimates that include, but are not limited to, the cause, timing and amount of the impairment.

Assets with a finite life. For IFRS purposes, during the year, the Group assesses whether there are any indicators that tangible and intangible assets with a finite life may have been impaired. If such indicators exists,

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the Group estimates if the carrying amount of an asset, a group of assets or a cash-generating unit exceeds the recoverable amount. Both internal and external sources of information are used to determine if indicators of impairment exist. Internal sources considered include obsolescence or physical damage, any significant changes in the use of the asset and the economic performance of the asset compared to estimated performance. External sources considered include market value of the asset, negative changes in technology, markets or laws, increases in market interest rates and the cost of capital used to evaluate investments, and the comparison of the carrying amount of net assets of the Group to market capitalization.

Intangible assets with an indefinite life. Intangible assets with an indefinite life, including goodwill, are tested for impairment at least annually to assess the recoverable amount of the asset. The test is conducted in conjunction with the planning process of the Group, near the end of every year. Goodwill acquired and allocated during the year is tested for impairment before the end of the year in which the acquisition and allocation took place. To test for impairment, goodwill is allocated, at the date of acquisition, to each of the cash-generating units or groups of cash-generating units that is expected to benefit from the acquisition. Allocation is made to the lowest level at which goodwill is monitored for management purposes and that lowest level is not larger than the business segment determined in accordance with IAS 14 (*Segment Reporting*).

Under IFRS, the recoverable amount of an asset is the higher of fair value less costs to sell and its value in use. In assessing the value in use, the pre-tax estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

The identification of impairment indicators, the estimation of future cash flows and the determination of fair values of assets, groups of assets (or cash-generating units) require management to make significant judgments concerning the identification and validation of impairment indicators, expected cash flows, applicable discount rates, useful lives and residual values. These estimates can have a material impact on fair value and the amount of any write-downs.

If the carrying amount of a cash-generating unit (or group of units) exceeds the recoverable amount, an impairment loss is recognized in the statement of operations. The impairment loss is first recognized as a deduction of the carrying amount of goodwill allocated to the cash-generating unit (or group of cash-generating units) and only then to the carrying amount of the other assets of the cash-generating unit in proportion to their carrying amount up to the recoverable amount of the assets.

The determination of the recoverable amount of a cash-generating unit involves the use of estimates by management.

When the conditions which led to the recognition of an impairment loss on assets cease to exist or have been mitigated, the carrying amount of the asset other than goodwill, or cash-generating unit, is increased to the revised estimate of its recoverable amount, but not in excess of the carrying amount that would have been recorded had no impairment loss been recognized and such reversal is recognized as income immediately.

Under U.S. GAAP, in order to assess impairment of property, plant and equipment and amortizing intangible assets, we apply the guidance outlined in SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. If, based on the preceding discussion, management has concluded that impairment indicators exist, we will initially review for possible impairment by assessing the undiscounted cash flows expected to be derived from the asset or group of assets, comparing the lowest level of total expected undiscounted cash flow to the carrying value. If the carrying value of the asset or the group of assets exceeds the sum of the undiscounted cash flows, impairment is considered to exist. An impairment charge is assessed by comparing the assets fair value to the carrying value. Fair value can be calculated by a number of different approaches, including discounted cash flow, comparables, market valuations or quoted market prices. The process and steps required to assess the possible impairments of assets, including the identification of possible impairment indicators, assessing undiscounted cash flows, selecting the appropriate discount rate, the calculation of the weighted average cost of capital and the discounts or premiums inherent in market prices requires a substantial amount of management discretion and judgment. If actual results differ from these estimates, or if the Telecom Italia Group adjusts these estimates in future periods, operating results could be significantly affected.

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Furthermore, for purposes of our U.S. GAAP reporting, in order to assess impairment of intangible assets with an indefinite life, we use the requirements of SFAS 142, *Goodwill and Other Intangible Assets*, and as a result we do not amortize goodwill and indefinite lived intangible assets (likewise under IFRS). SFAS 142 requires that goodwill be tested for impairment at least annually (and between annual tests when certain triggering events occur) using a two-step methodology. The first step screens for triggering events indicating potential impairment at the reporting unit level, while the second step measures the impairment, if any. Under U.S. GAAP, the quoted market price of an asset or other valuation techniques, including discounted cash flow, comparables, etc., are acceptable valuation methodologies to assess fair value. The selection of the various assumptions that are necessary to arrive at the fair value of a reporting unit, including the assumptions used in the underlying business plans or targets, requires substantial management judgment and discretion.

Subsequent reversals of recognized impairment losses on goodwill and other indefinite lived intangible assets are not permitted by SFAS 142.

5.3.6 FINANCIAL ASSETS

Financial assets include, in particular, equity investments mainly in telecommunications companies that are principally engaged in the mobile, fixed-line network, Internet and data communications businesses, some of which are publicly traded and have highly volatile share prices. Generally, an impairment charge is recorded, in accordance with IFRS, when an investment's carrying amount exceeds the present value of its estimated future cash flows, and, in accordance with U.S. GAAP, when a decline in fair value is considered to be other than temporary. The calculation of the present value of estimated future cash flows and the determination of whether an impairment is other than temporary involve judgments and relies heavily on assessments by management regarding the future development and prospects of the investee company. In determining value, quoted market prices are used, if available, or other valuation methodologies. To determine whether an impairment is other than temporary, we consider the ability and intent to hold the investment for a reasonable period of time to ascertain whether a forecasted recovery of fair value exceeds the carrying amount, including an assessment of factors such as, the length of time and magnitude of the excess of carrying value over market value, the forecasted results of the investee company, the regional economic environment and state of the industry. Future adverse changes in market conditions, particularly a downturn in the telecommunications industry, or poor operating results could result in losses or an inability to recover the carrying amount of the investment, which could result in impairment charges.

5.3.7 DERIVATIVES

Telecom Italia enters into several different types of derivative contracts in order to adjust and manage the various cash flows associated with foreign currency and interest rate exposures. Under IFRS, the changes in the fair value of instruments which do not qualify for hedge accounting, fair value hedges, ineffective portion of cash flow hedges, are recognized in the statement of operations in the period of change. The gain or loss on the effective portion of qualifying cash flow hedges is reported in Other Comprehensive Income. The assessment of the fair value of a derivative contract requires the use of quoted market prices, banker price quotations, price quotations for similar instruments traded in different markets and, where applicable, pricing models. Pricing models and their underlying assumptions impact the amount and timing of unrealized gains and losses recognized. The Group relies on these pricing models when external fair values are unavailable. The estimates regarding future prices require estimating several factors, including interest rates, currency values and cash flows. Prices realized in the future could differ from these estimates, therefore producing different financial results.

5.3.8 EMPLOYEE SEVERANCE INDEMNITIES

Employee severance indemnities (or *Trattamento di Fine Rapporto TFR*) are a form of post employment benefits and are classified and accounted for as a defined benefit plan. The obligation for employee severance indemnities is determined in accordance with actuarial methods, which rely on assumptions including discount rates, services periods, future salary increases and life expectancies.

In the event that changes in assumptions are required, with respect to these assumptions the future amounts of the post employment benefit costs may be materially affected.

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5.3.9 PROVISIONS AND CONTINGENT LIABILITIES

The Group exercises considerable judgment in determining our exposure to and recognizing provisions for contingent liabilities related to pending litigation or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation as well as other contingent liabilities.

Judgment is necessary in assessing the likelihood that a pending claim will succeed or a liability will arise and to quantify the possible range of the final settlement. Provisions are recorded for liabilities when losses are considered probable and can be reasonably estimated. Because of the inherent uncertainties in making such judgments, actual losses may be different from the originally estimated provision. Significant estimates are involved in the determination of provisions related to taxes, environmental liabilities, our workforce reduction initiative and litigation risks. These estimates are subject to change as new information becomes available, primarily with the support of internal specialists or outside consultants, such as actuaries or legal counsel. Adjustments to loss provisions may significantly affect future operating results.

5.3.10 INCOME TAXES

The Group calculates income taxes in each of the tax jurisdictions in which it operates. This process involves a jurisdiction-by-jurisdiction calculation of the current tax charge and an assessment of temporary differences resulting from the different treatment of certain items for IFRS consolidated financial and tax reporting purposes. Temporary differences result in the recognition of deferred tax assets or liabilities in the consolidated financial statements. Deferred tax assets are recognized to the extent that their realization is probable. The realization of deferred tax assets depends, among other things, on the company's ability to generate sufficient taxable income in future years and the reversal of temporary liabilities, taking into account any restrictions on the carryforward of tax losses. Various factors are used to assess the probability of the future realization of deferred tax assets, including future reversals of existing taxable temporary differences, past operating results, operational plans, loss-carryforward periods, and tax planning strategies. If actual results differ from these estimates or if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be affected. In the event of a change in the assessment of future utilization of deferred tax assets, the recognized deferred tax assets must be increased or decreased, as the case may be, and the consequent effects recognized in the statement of operations.

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Adoption Of International Financial Reporting Standards

5.4 ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS

Telecom Italia adopted IFRS for the first time in its annual Consolidated Financial Statements for the year ended December 31, 2005, which included comparative financial statements for the year ended December 31, 2004. IFRS 1, *First-time Adoption of International Financial Reporting Standards*, requires that an entity develop accounting policies based on the standards and related interpretations effective at the reporting date of its first annual IFRS financial statements (i.e., for Telecom Italia, December 31, 2005). IFRS 1 also requires that those policies be applied as of the date of transition to IFRS (i.e., for Telecom Italia, January 1, 2004) and throughout all periods presented in the first IFRS financial statements.

For the purposes of these Financial Statements there are no differences between IFRS issued by IASB and IFRS adopted by the EU.

The differences arising from the application of IFRS compared to Italian GAAP as well as the choices made by Telecom Italia among the accounting options provided by IFRS are described in Note 42 Transition to International Financial Reporting Standards (IFRS) of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report.

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5.5 RESULTS OF OPERATIONS FOR THE TWO YEARS ENDED DECEMBER 31, 2005

5.5.1 REORGANIZATION OF BUSINESS

During 2005 the Telecom Italia Group continued the reorganization process that began in 2001 when, following the acquisition by Olimpia, the new management started implementing a restructuring plan. The most recent organizational and structural changes reflect the Group's adoption of the "One Company" model and market developments in which convergence of services (fixed, mobile and internet) has been accelerating.

The Telecom Italia businesses at December 31, 2005 are organized on the basis of the following Business Units or Corporate Functions:

- **Operations**, which is responsible for the management and development of fixed and mobile telecommunications and internet services. Operations, for reporting purposes, is divided into:

Wireline, which operates on a national level by providing wireline telephone, data and internet services for final customers (retail) and other operators (wholesale). On an international level, Wireline develops fiber optic networks for wholesale customers (in Europe and in South America) and offers innovative broadband services in certain metropolitan areas in Germany, France and The Netherlands.

Mobile, which operates in the sector of national and international mobile telecommunications. Its international presence is concentrated in South America (Brazil).

- **Business Units** which are responsible for the development of the following businesses:

Media, which operates in the area of journalistic information, TV production, TV and web content offerings.

Olivetti, which operates in the market of specialized applications for the banking field and retail, information and computer systems for gaming, lotteries and e-vote systems as well as in the research/development/production of products using silicon.

For a complete description of these businesses, see Item 4. Information on the Telecom Italia Group 4.2 Business Units . For purposes of the following discussion selected financial data of each Business Unit has been provided for 2004 and 2005, consistent with the structure of each Business Unit at December 31, 2005.

5.5.2 NON-GAAP FINANCIAL MEASURES

In this annual report on Form 20-F, in addition to figures presented in accordance with IFRS, we disclose figures derived from IFRS that are non-GAAP financial measures (**Non-GAAP Measures**). Such financial data is considered Non-GAAP financial measures as defined in Item 10 of Regulation S-K under the 1934 Act.

As described in more detail below, such financial data is presented as additional information for Telecom Italia's investors and should not be considered as substitutes for or confused with economic and financial IFRS measures.

In this Annual Report the only Non-GAAP Measures utilized refer to Net Financial Debt.

Net Financial Debt is a Non-GAAP financial measure as defined in Item 10 of Regulation S-K under the 1934 Act, but is widely used in Italy by financial institutions to assess liquidity and the adequacy of a company's financial structure. We believe that Net Financial Debt provides an accurate indicator of our ability to meet its financial obligations, represented by gross debt, by its available liquidity, represented by the other items shown in the reconciliation table. Net Financial Debt allows us to show investors the trend in our net financial condition over the periods presented. The limitation on the use of Net Financial Debt is that it effectively assumes that gross debt can be reduced by our cash and other liquid assets. In fact, it is unlikely that we would use all of our liquid assets to reduce our gross debt all at once, as such assets must also be available to pay employees, suppliers, and taxes, and to meet other operating needs and capital expenditure requirements. Net Financial Debt and its ratio to total shareholders' equity (including minority interests), or leverage, are used to evaluate our financial structure in terms of sufficiency and cost of capital, level of debt, debt rating and funding cost, and whether our financial structure is adequate to achieve our business plan and our financial targets (which include our debt ratio, or Net Financial Debt divided by net invested capital, the latter meaning net assets excluding Net Financial Debt). Our management believes that our financial structure is sufficient to achieve our business plan and financial targets.

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Our management monitors the Net Financial Debt and leverage or similar measures as reported by other telecommunications operators in Italy and abroad, and by other major listed companies in Italy, in order to assess our liquidity and financial structure relative to such companies. We also monitor the trends in our Net Financial Debt and leverage in order to optimize the use of internally generated funds versus funds from third parties. Net Financial Debt is reported in our Italian Annual Report to shareholders and is used in presentations to investors and analysts. Net Financial Debt is calculated as follows:

	As of December 31,	
	2004	2005
	(millions of Euro)	
GROSS FINANCIAL DEBT		
Non-current financial liabilities (Long-term debt)		
Financial payables	36,862	40,252
Finance lease liabilities	1,860	1,894
Other financial liabilities	3	
	38,725	42,146
Current financial liabilities (Short-term debt), excluding financial debt relating to discontinued operations/assets held for sale		
Financial payables	4,168	9,572
Finance lease liabilities	227	234
Other financial liabilities	5	6
	4,400	9,812
Financial debt relating to discontinued operations/assets held for sale	188	143
TOTAL GROSS FINANCIAL DEBT (A)	43,313	52,101
FINANCIAL ASSETS		
Non-current financial assets		
Securities other than equity investments	7	8
Financial receivables and other non-current financial assets	386	988
	393	996
Current financial assets, excluding financial assets relating to discontinued operations/assets held for sale		
Securities other than equity investments	457	378
Financial receivables and other current financial assets	662	509
Cash and cash equivalents	8,855	10,323
	9,974	11,210
Financial assets relating to discontinued operations/assets held for sale	84	37
TOTAL FINANCIAL ASSETS (B)	10,451	12,243

NET FINANCIAL DEBT (A-B)	32,862	39,858
---------------------------------	---------------	---------------

5.5.3 OVERVIEW OF 2005 RESULTS OF OPERATIONS

For the 2005-2007 period we have established certain key targets:

- Strengthen our core Italian domestic activities.
- Exploit growth opportunities.
- Improve cost efficiency.

With respect to the strengthening of our core Italian domestic activities we achieved the following:

- during 2005 our traffic packages and retention strategies resulted in limited revenue losses while our market share on traffic volumes remained stable: our market share on traffic volumes at December 31, 2005 was 72.3% compared with 71.7% at December 31, 2004. The Wireline Business Unit has implemented various strategies to limit the impact of increasing competition, with such strategies designed to retain customers and minimize the impact of tariff reductions;

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- Mobile Italy total traffic volumes increased by 3.3% in terms of minutes and revenues increased by 1.5% in 2005 compared to 2004 (10,076 million in 2005 against 9,923 million in 2004). The growth in revenue was mainly attributable to the higher impact of VAS revenues and was achieved in spite of a 19% regulatory cut to mobile termination rates in September 2005. The average monthly revenue per mobile line (ARPU) (which includes traffic and VAS revenues) decreased from approximately 29.0 in 2004 to 28.3 in 2005 (excluding service revenues from non Mobile Italy clients).

In both our core domestic and international markets our strategy remains to focus our investment on exploiting growth opportunities. In the domestic market our focus has been on value added services and internationally on markets which we consider to have the most potential for growth mobile telecommunications in Brazil and broadband in selected European markets.

Innovative offering:

- the Wireline Business Unit is focused on converting its customers from traditional to innovative technologies to enlarge IP services and applications. The Wireline Business Unit is expanding its penetration in the retail broadband market through ADSL connections offered respectively to the consumer and SOHO (Small Office Home Office) markets with two different branded packages: Alice and Alice Business . This strategy has had significant success in Italy with approximately 5.7 million broadband accesses sold to the retail and the wholesale market at the end of 2005 (approximately 4 million at December 31, 2004);
- Mobile Italy revenues from Value Added Services (VAS) (1,449 million in 2005) increased by 15.4% compared to 2004. Due to the continuing introduction of new services and the success of interactive VAS, the VAS business grew significantly with its revenues representing 15.5% of service revenues, compared to 13.4% in 2004.

International markets:

- during 2005, we expanded the activities of the International Broadband project in Europe. The Wireline Business Unit intends to offer access to innovative broadband services in the main European countries, leveraging on its know-how and technological assets, beginning with France and Germany. As of December 31, 2005, Wireline had approximately 1,3 million contracts for broadband access outside of Italy (420,000 as of December 31, 2004);
- we continued to consolidate our role in Brazil during 2005. As of December 31, 2005, in addition to mobile customers in Italy, we had approximately 20.2 million total managed lines in our Brazilian subsidiaries.

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The following table sets forth statement of operations in accordance with IFRS for the years ended December 31, 2004, and 2005.

	Year ended December 31,	
	2004	2005
	(millions of Euro)	
Statement of Operations Data in accordance with IFRS:		
Revenues	28,292	29,919
Other income	1,099	678
Total operating revenues and other income	29,391	30,597
Purchases of materials and external services	(11,812)	(12,937)
Personnel costs	(3,852)	(4,142)
Other operating expenses	(1,603)	(1,468)
Changes in inventories	27	(4)
Capitalized internal construction costs	713	471
Depreciation and amortization	(4,808)	(5,232)
Gains/losses on disposals of non-current assets	(9)	242
Impairment losses/reversals on non-current assets	(444)	(28)
Total operating expenses	(21,788)	(23,098)
Operating income	7,603	7,499
Share of earnings of equity investments accounted for using the equity method	(5)	23
Financial income	2,205	3,144
Financial expenses	(4,197)	(5,131)
Income from continuing operations before taxes	5,606	5,535
Income taxes	(2,654)	(2,395)
Net income from continuing operations	2,952	3,140
Net income (loss) from discontinued operations/assets held for sale	(118)	550
Net income	2,834	3,690
<i>Of which:</i>		
• <i>Net income attributable to the Group</i>	1,815	3,216
• <i>Net income attributable to Minority interests</i>	1,019	474

5.5.4 BUSINESS UNIT FINANCIAL DATA

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We operate mainly in Europe (principally in Italy), the Mediterranean Basin and South America. Our core business is focused on domestic and international telecommunications services.

The table below sets forth revenues, operating income, capital expenditures and number of employees by Business Units, for the last two years:

		Wireline (1)(2)	Mobile	Media (1)	Olivetti (4)	Other activities (2)(3)	Adjustments and Eliminations	Consolidated Total
(millions of Euro, except number of employees)								
Revenues(5)	2005	17,802	12,963	180	452	1,680	(3,158)	29,919
	2004	17,431	11,712	168	590	1,635	(3,244)	28,292
Operating income	2005	4,566	3,661	(130)	(38)	(615)	55	7,499
	2004	4,756	3,850	(93)	17	(715)	(212)	7,603
Capital expenditures	2005	2,670	2,118	65	19	308	(7)	5,173
	2004	2,267	2,288	39	15	393		5,002
Number of employees at year-end(6)	2005	55,990	20,767	886	1,750	6,091		85,484
	2004	54,090	18,743	1,077	2,109	6,601		82,620

(1) On June 1, 2005, Telecom Italia acquired all of Telecom Italia Media's Internet activities (Nuova Tin.it and Matrix); as a result, the Internet activities are included in the Wireline Business Unit for all periods presented, while they have been considered as discontinued operations in the Media Business Unit.

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- (2) The operating activity IT Group is no longer presented since it is now included in the Wireline Business Unit and in Other Activities following the merger of IT Telecom with Telecom Italia which took place at the end of 2004.
- (3) Entel Bolivia group is included in Other Activities.
- (4) On April 5, 2005, Olivetti Tecnost S.p.A. changed its name to Olivetti S.p.A..
- (5) Revenues are total revenues of the various business units of the Telecom Italia Group before elimination of intercompany sales (but after elimination of sales between companies within the same major business area).
- (6) The number of employees at year-end excludes employees relating to the consolidated companies considered as discontinued operations/assets held for sale, and includes temporary employees. For purposes of comparison with December 31, 2005, the number of employees at December 31, 2004 has been adjusted in order to include as discontinued operations /assets held for sale those companies that are considered as such at December 31, 2005.

The table below sets forth revenues, operating income, net income (loss) from discontinued operations/assets held for sale, capital expenditures and number of employees of the activities considered discontinued operations/ assets held for sale, for the last two years:

		Discontinued operations/Assets held for sale						
		Mobile	Media	Entel Chile group	IT Market	Sub-Total	Others, adjustments and eliminations	Total
		(1)	(2)	group	Market	Sub-Total	(3)	Total
		(millions of Euro)						
Revenues	2005	734	126	238	289	1,387	(53)	1,334
	2004	1,177	127	925	706	2,935	(142)	2,793
Operating income(3)	2005	60	4	36	(3)	97	506	603
	2004	125	4	96	21	246	(202)	44
Net income (loss) from discontinued operations/ assets held for sale	2005	28	1	26	(11)	44	506	550
	2004	58	1	49	(7)	101	(219)	(118)
Capital expenditures	2005	87	3	27	5	122		122
	2004	200	2	141	28	371		371
Number of employees at year-end (number)	2005	863	184			1,047		1,047
	2004	841			4,030	4,871		4,871
	2004 adjusted(*)	2,961	195	4,216	4,030	11,402		11,402

(*) The number of employees at December 31, 2005 is compared both with the adjusted number of employees at December 31, 2004 (which consider as discontinued operations / assets held for sale the same companies considered as such at December 31, 2005, namely: the Finsiel Group, Corporacion Digitel, the Entel Chile group, TIM Hellas, TIM Perù and Gruppo Buffetti) and with the historical number of employees at December 31, 2004 (which consider as discontinued operations / assets held for sale the Finsiel Group and Corporacion Digitel).

(1) Includes TIM Hellas, TIM Perù and Corporacion Digitel.

(2) Includes the Gruppo Buffetti.

(3) Adjustments and eliminations relating to the operating income include, among other things:

- 2005: the gains on the sale of TIM Hellas (410 million, net of the related incidental charges) and TIM Perù (120 million, net of the related incidental charges), as well as other losses and incidental charges relating to the sale of the Entel Chile group, the Finsiel Group and Gruppo Buffetti, for a total of 24 million;
- 2004: the adjustment of the estimated selling price of the Entel Chile group (a loss of 177 million) and the Finsiel group (a loss of 28 million).

5.5.5 YEAR ENDED DECEMBER 31, 2005 COMPARED WITH YEAR ENDED DECEMBER 31, 2004

In 2005, our **consolidated net income** was 3,216 million (net income of 3,690 million before minority interests), compared to consolidated net income of 1,815 million (net income of 2,834 million before minority interests) in 2004.

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The increase of 1,401 million in 2005 was principally due to the following factors:

- a higher share of earnings of equity investments accounted for using the equity method (28 million);
- lower financial expenses, net of financial income (5 million). In particular, in 2005, financial income included the release to the statement of operations of a portion of reserves recorded in 2002 for the guarantees provided by the Group to banks which had financed AVEA I.H.A.S., our interest in mobile operations in Turkey, since the risk had ceased with the cancellation of the same guarantees (423 million), partially offset by higher financial expenses due to the increase in indebtedness connected with the tender offer for TIM shares and lower capital gains from the management of equity investments (418 million);
- lower income taxes (259 million);
- higher net income from discontinued operations / assets held for sale of 668 million (a net income of 550 million in 2005 compared to a net loss of 118 million in 2004), including, in particular, 410 million relating to the net gain realized on the sale of the entire investment held in TIM Hellas and 120 million relating to the net gain realized on the sale of the entire investment held in TIM Perù; and
- lower minority interests of 545 million in net income (474 million in 2005 compared to 1,019 million in 2004), mainly arising from the integration of TIM (tender offer and merger), which led to a full control over the Italian Mobile business.

These factors which increased net income were offset in part by a decrease in operating income of 104 million.

V REVENUES

Our **consolidated revenues** in 2005 were 29,919 million, an increase of 1,627 million or 5.8% compared to 28,292 million in 2004.

Revenues from telecommunications services are shown gross of the portion due to third-party operators of 4,713 million (4,177 million in 2004).

Foreign revenues amounted to 6,165 million in 2005 (4,556 million in 2004); 51.1% of the total came from the South America area (44.7% in 2004), principally Brazil.

The table below sets forth, for the periods indicated, gross revenues and consolidated revenues by Business Unit and the percentage of their contributions to our consolidated revenues:

Year ended December 31,

	2004(1)(2)			2005(2)		
	Gross Revenues(1)	Consolidated Revenues(2)	% of Consolidated Revenues	Gross Revenues(1)	Consolidated Revenues(2)	% of Consolidated Revenues
(millions of Euro, except percentages)						
Wireline(3)(4)	17,431	15,844	56.0%	17,802	16,348	54.6%
Mobile	11,712	11,457	40.5%	12,963	12,672	42.4%
Media(3)	168	165	0.6%	180	176	0.6%
Olivetti(5)	590	536	1.9%	452	400	1.3%
Other Activities(4)(6)	1,635	290	1.0%	1,680	323	1.1%
Total revenues	31,536	28,292	100.0%	33,077	29,919	100.0%

(1) Gross revenues are total revenues of the various business units of the Telecom Italia Group before elimination of intercompany sales (but after elimination of sales between companies within the same major business area).

(2) Data include revenues recorded by each business area on a consolidated basis after elimination of intercompany sales.

(3) On June 1, 2005, Telecom Italia acquired all of Telecom Italia Media's Internet activities (Nuova Tin.it and Matrix); as a result, revenues from the Internet activities are included in the Wireline Business Unit for all periods presented, while they have been considered as discontinued operations in the Media Business Unit.

(4) Revenues related to the operating activity IT Group are included in the Wireline Business Unit and in Other Activities following the merger of IT Telecom with Telecom Italia which took place at the end of 2004.

(5) On April 5, 2005, Olivetti Tecnost S.p.A. changed its name to Olivetti S.p.A..

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- (6) Other activities consist of the Central Functions (Group Functions and Service Units) and the foreign operations not included in other business units (the consolidated subsidiary Entel Bolivia group, the associates Telecom Argentina group and Brasil Telecom). For further details on Other Activities please see Item 4. Information on the Telecom Italia Group 4.2 Business Units 4.2.5 Other Telecom Italia Group Activities .

The table below sets forth, for the periods indicated, revenues by geographic area and the percentage of total consolidated revenues:

Geographic area	Year ended December 31,			
	2004		2005	
	(millions of Euro, except percentages)			
Italy	23,736	83.9%	23,754	79.4%
Rest of Europe	1,746	6.2%	2,265	7.6%
North America	398	1.4%	374	1.2%
Central and South America	2,036	7.2%	3,147	10.5%
Australia, Africa and Asia	376	1.3%	379	1.3%
Total consolidated revenues	28,292	100.0%	29,919	100.0%

V OTHER INCOME

Other income amounted to 678 million, a decrease of 421 million compared to 2004. Details are as follows:

	Year ended December 31,	
	2004	2005
	(millions of Euro)	
Compensation for late payment of regulated telephone services	85	107
Release of reserves and other liabilities	162	228
Recovery of costs of personnel and services rendered	35	35
Capital grants	52	39
Damage compensation and recovery	18	20
Grants related to income	12	8
Income from release of prior year TLC operating fee	546	
Other income	189	241
Total	1,099	678

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In particular the decrease in Other income was principally due to the fact that the 2004 statement of operations benefited from 546 million relating to the release of the TLC license fee paid by Telecom Italia and TIM for the year 1999, following the ruling by the TAR of Lazio Regional Administrative Court on January 4, 2005. For further details please see Note 25 Commitments and potential liabilities of the Notes to the Consolidated Financial Statements included elsewhere herein.

V OPERATING EXPENSES

The table below sets forth, for the periods indicated, total consolidated **operating expenses** by major components and expressed as a percentage of total consolidated revenues.

	Year ended December 31,			
	2004		2005	
	(millions of Euro, except percentages)			
Purchases of materials and external services	11,812	41.8%	12,937	43.2%
Personnel costs	3,852	13.6%	4,142	13.9%
Other operating expenses	1,603	5.7%	1,468	4.9%
Changes in inventories	(27)	(0.1)%	4	
Capitalized internal construction costs	(713)	(2.5)%	(471)	(1.6)%
Depreciation and amortization	4,808	17.0%	5,232	17.5%
Gains/losses on disposals of non-current assets	9		(242)	(0.8)%
Impairment losses/reversals on non-current assets	444	1.5%	28	0.1%
Total operating expenses	21,788	77.0%	23,098	77.2%

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Our operating expenses increased by 1,310 million in 2005 compared to 2004 and are detailed as follows:

- **Purchases of materials and external services** increased by 1,125 million (or 9.5%), from 11,812 million in 2004 to 12,937 million in 2005; the percentage of purchases of materials and external services to revenues was 43.2% (41.8% in 2004).

Purchases of materials and external services included:

	Year ended December 31,	
	2004	2005
	(millions of Euro)	
Purchases of materials and merchandise for resale	(A) 2,203	2,506
Costs of services:		
- Revenues due to other TLC operators	4,177	4,713
- Commissions, sales commissions and other selling expenses	1,006	1,263
- Advertising and promotion expenses	504	593
- Professional consulting and services	609	546
- Utilities	244	308
- Other service expenses	2,121	1,904
	(B) 8,661	9,327
Lease and rental costs:		
- Property lease rents	624	641
- TLC circuit lease rents and rents for use of satellite systems	154	274
- Other lease and rental costs	170	189
	(C) 948	1,104
Total purchases of materials and external services	(A+B+C) 11,812	12,937

The principal reasons for the increase were:

- Purchases of materials and merchandise for resale increased by 303 million, from 2,203 million in 2004 to 2,506 million in 2005. This increase was attributable to, among other things, sales of 3G handsets as the UMTS services were more broadly offered in 2005, as well as to innovative terminals (Aladino cordless phones and phones for videocommunication);

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- Revenues due to other TLC operators increased by 536 million, from 4,177 million in 2004 to 4,713 million in 2005, mainly as a result of the increase of the related revenues;
- Commissions, sales commissions and other selling expenses increased by 257 million, from 1,006 million in 2004 to 1,263 million in 2005, principally as a result of the increase in mobile customers in 2005.
- **Personnel costs** increased by 290 million (or 7.5%), from 3,852 million in 2004 to 4,142 million in 2005. Such increase was principally due to charges for mobility agreements pursuant to Law no. 223/1991 and to the extraordinary executives termination benefit plan totalling 273 million; excluding these charges personnel costs would have increased by 0.4%. The percentage of personnel costs to revenues was 13.8% in 2005 compared to 13.6% in 2004.

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Personnel costs are detailed as follows:

	Year ended December 31,	
	2004	2005
	(millions of Euro)	
Personnel costs at payroll:		
- Wages and salaries	2,566	2,577
- Social security contributions	803	807
- Employee severance indemnities	183	168
- Pensions and similar obligations (Defined benefit plans)	4	2
- Other employee-related costs	59	85
	(A)	3,615
Temporary labour costs	(B)	38
Miscellaneous expenses for personnel and for other labour-related services rendered:		
- Remuneration of personnel other than employees	17	18
- Costs and provision charges for termination benefit incentives	182	151
- Charges related to mobility agreements pursuant to Law No. 223/1991 and to the extraordinary executives termination benefit plan		273
- Other		9
	(C)	199
Total personnel costs	(A+B+C)	3,852
		4,142

The Group's average equivalent number of employees in 2005 was 79,869 units (excluding employees related to discontinued operations/assets held for sale and including temporary employees) compared to 79,602 units in 2004. The breakdown by category is as follows:

	Year ended December 31,	
	2004	2005
	(Units)	
Executives	1,592	1,541
Middle management	4,597	4,744
White collars	70,540	70,375
Blue collars	920	722

Total employees at payroll	77,649	77,382
Temporary employees	1,953	2,487
	<hr/>	<hr/>
Total employees	79,602	79,869
	<hr/>	<hr/>

- **Other operating expenses** decreased by 135 million (or 8.4%), from 1,603 million in 2004 to 1,468 million in 2005. Such operating expenses consist of the following:

	Year ended December 31,	
	2004	2005
	(millions of Euro)	
Impairment and provision for bad debts	498	521
Provisions to reserves for risks and future charges	289	71
TLC operating fees	114	181
Taxes on revenues of South American companies	112	178
Duties and indirect taxes	153	141
Association fees and dues	18	19
Other expenses	419	357
	<hr/>	<hr/>
Total other operating expenses	1,603	1,468
	<hr/>	<hr/>

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The decrease in Other operating expenses was mainly due to the reduction in Provisions to reserves for risks (289 million in 2004 and 71 million in 2005) and future charges which in 2004 included the provision of 152 million recorded against the fine levied by the Antitrust Authority for the alleged abuse of a dominant position in the market (for further details please see Note 25 Commitments and Potential Liabilities of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report).

- **Capitalized internal construction costs** include sales of equipment, installations and services at market prices by Group companies, principally to Telecom Italia and Mobile Italy. These costs decreased by 242 million (or 33.9%), from 713 million in 2004 to 471 million in 2005, and consist of the following:

	Year ended December 31,	
	2004	2005
	(millions of Euro)	
Intra-group revenues for the sale of:		
Intangible assets with a finite life	49	105
Tangible assets	18	29
	(A)	67
Capitalized internal construction costs on:		
Intangible assets with a finite life	473	182
Property, plant and equipment owned	173	155
	(B)	646
Total capitalized internal construction costs	(A+B)	713
		471

The reduction in 2005 when compared to 2004 was due to the use of a different accounting method. In 2004, the external costs relating to contracts that had to be capitalized were recorded in the statement of operations, whereas, in 2005, such costs were booked directly to the capital asset account.

- **Depreciation and amortization** increased by 424 million (or 8.8%), from 4,808 million in 2004 to 5,232 million in 2005; the percentage of depreciation and amortization to revenues was 17.5% (17.0% in 2004). Such increase was in part due to the higher levels of amortizable assets (in particular Industrial patents and intellectual property rights) also as a result of the higher investments made in 2004 and 2005.

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Depreciation and amortization are detailed as follows:

	Year ended December 31,	
	2004	2005
(millions of Euro)		
Amortization of Intangible assets with a finite life:		
Industrial patents and intellectual property rights	1,106	1,414
Concessions, licenses, trademarks and similar rights	224	253
Other intangible assets	16	17
	(A)	1,684
Depreciation of Tangible assets owned:		
Civil and industrial buildings	103	103
Plant and equipment	2,869	2,910
Manufacturing and distribution equipments	27	31
Aircrafts and ships	12	9
Other assets	313	363
	(B)	3,416
Depreciation of Tangible assets held under finance lease:		
Civil and industrial buildings	93	93
Plant and equipment		1
Aircrafts and ships	4	4
Other assets	41	34
	(C)	132
Total depreciation and amortization	(A+B+C)	4,808
		5,232

- **Gains/losses on disposals of non-current assets** changed from a net loss of 9 million in 2004 to a net gain of 242 million in 2005. In particular, in 2005, such item included the gains of 264 million relating to certain real estate transactions carried out by the Group with closed-end real estate funds Raissa and Spazio Industriale. Such transactions were executed as part of the Group's continuing real estate disposal program.
- **Impairment losses** decreased by 416 million (or 93.7%), from a loss of 444 million in 2004 to a loss of 28 million in 2005. In 2004, such item included 282 million related to the De Agostini transaction for the purchase of 40% of Finanziaria Web, as well as provisions and impairment losses on intangible and tangible assets (162 million).

V **OPERATING INCOME**

Operating income decreased from 7,603 million in 2004 to 7,499 million in 2005, a 1.4% decrease. As a percentage of revenues, operating income was 25.1% in 2005 (26.9% in 2004).

V **SHARE OF EARNINGS OF EQUITY INVESTMENTS ACCOUNTED FOR USING THE EQUITY METHOD**

The **Share of earnings of equity investments accounted for using the equity method** was a positive 23 million (negative 5 million in 2004).

This item includes:

	Year ended December 31,	
	2004	2005
	(millions of Euro)	
Avea I.H.A.S.		(122)
ETECSA	(6)	45
Solpart Participações S.A.		94
Sofora Telecomunicaciones S.A.		16
Others	1	(10)
Total share of earnings of equity investments accounted for using the equity method	(5)	23

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In particular:

- 94 million relates to restoring the equity method of accounting for the investment in Solpart Participações through which Telecom Italia holds its interest in Brasil Telecom. Following the agreements signed on April 28, 2005, Telecom Italia reinstated its governance rights in Solpart Participações, temporarily suspended from August 2002, resuming its role in the management of the company;
- 16 million relating to Sofora Telecomunicaciones, the company through which Telecom Italia holds its interest in Telecom Argentina, mainly due to the significant result achieved by Telecom Argentina at the conclusion of the debt restructuring plan (at the end of August 2005) and following the positive effect on shareholder's equity. The debt restructuring followed Telecom Argentina's default on its obligations in 2001 on account of the monetary crisis in Argentina;
- the loss of 122 million relating to Avea I.H.A.S. (the group's mobile operations in Turkey) relates to the Group's share of the loss for 2005 of such associate. In 2004, the share of the loss had not been recognized as the investment was carried at zero value; and
- 45 million relates to the Group's share of income for 2005 of ETECSA (the operator of the Cuban telecommunications system); during 2004, the positive adjustment to ETECSA's equity was more than offset by the impairment of goodwill.

For further details about the above mentioned equity investments accounted for using the equity method please see Item 4. Information on the Telecom Italia Group 4.2 Business Units 4.2.2 Mobile Other Investments, Item 4. Information on the Telecom Italia Group 4.2 Business Units 4.2.5 Other Telecom Italia Group Activities, and Note 9 Other Non-current assets of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report.

V FINANCIAL INCOME AND EXPENSES, NET

Total financial income and expenses showed a net expense balance of 1,987 million (a net expense balance of 1,992 million in 2004), representing an improvement of 5 million compared to 2004. Such reduction was mainly due to:

	Year ended December 31,	
	2004	2005
	(millions of Euro)	
Financial income	2,205	3,144
Financial expenses	(4,197)	(5,131)
Total financial income and expenses, net	(1,992)	(1,987)

Financial income mainly consisted of:

- income from equity investments amounting to 95 million in 2005 (212 million in 2004); the decrease of 117 million was mainly due to the lower gains on the sale of equity investments;
- other financial income amounting to 2,001 million in 2005 (1,197 million in 2004), that increased of 804 million mainly as a result of:
 - the release of reserves for 423 million recorded in respect of guarantees issued to certain banks which had financed the Turkish associate Avea, since there was no longer a risk following the cancellation of the guarantees;
 - foreign exchange gains which increased by 223 million compared to 2004 (from 312 million in 2004 to 535 million in 2005);
 - income from fair value hedge derivatives that increased by 175 million compared to 2004 (from 290 million in 2004 to 465 million in 2005);
- positive fair value adjustments related to fair value hedge derivatives, underlying financial assets and liabilities of fair value hedges and non-hedging derivative financial instruments that increased in total by 277 million compared to 2004 (from 768 million in 2004 to 1,045 million in 2005).

For further details about Financial income please see Note 35 Financial income of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report.

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Financial expenses mainly consisted of:

- interest expense and other borrowing costs amounted to 3,972 million in 2005 (3,322 million in 2004), an increase of 650 million mainly as a result of:
 - interest expense to banks which increased by 251 million compared to 2004 (from 45 million in 2004 to 296 million in 2005), mainly relating to the credit facilities for the financing of the tender offer on TIM shares and other purchases on the market which had an impact in terms of both increased debt levels and lower liquidity as certain cash resources were used to retire some of this debt early;
 - foreign exchange losses which increased by 103 million compared to 2004 (from 330 million in 2004 to 433 million in 2005);
 - charges from fair value hedge derivatives that increased by 112 million compared to 2004 (from 152 million in 2004 to 264 million in 2005);
- negative fair value adjustments related to fair value hedge derivatives, underlying financial assets and liabilities of fair value hedges and non-hedging derivative financial instruments that increased in total by 364 million compared to 2004 (from 771 million in 2004 to 1,135 million in 2005).

For further details about Financial expenses please see Note 36 Financial expenses of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report.

V NET INCOME FROM CONTINUING OPERATIONS

Net income from continuing operations increased by 188 million (or 6.4%), from 2,952 million in 2004 to 3,140 million in 2005. Although income from continuing operations before taxes decreased by 71 million (from 5,606 million in 2004 to 5,535 million in 2005), such increase was attributable to the 259 million decrease in income taxes due, in addition to the lower taxable income, to the realignment made by Tim Italia, in its statutory financial statements with the tax figures, the latter being lower as a result of accelerated depreciation and the amortization of the UMTS license on which tax interference had already been eliminated in 2004 financial statements of TIM S.p.A.. This realignment led to a provision for substitutional tax of 43 million and the reduction in the reserve for deferred taxes of 135 million.

V NET INCOME (LOSS) FROM DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE

Net income (loss) from discontinued operations/assets held for sale amounted to 550 million in 2005 (a net loss of 118 million in 2004) and included:

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- gain on the sale of TIM Hellas (410 million, net of related ancillary charges) and TIM Perù (120 million, net of related ancillary charges), and other losses and ancillary expenses for the sale of the Entel Chile group, Finsiel group and Gruppo Buffetti for a total amount of 24 million. During 2004, net loss from discontinued operations/assets held for sale included: the impairment loss on the goodwill related to Entel Chile (177 million), the provision related to Finsiel for the adjustment to the estimated sale price (28 million) and other provisions related to companies held for sale (mainly Entel Chile group, 14 million);
- net income of the Entel Chile group of 26 million, referring only to the first three months of 2005 (net income of 49 million in 2004);
- net loss of the Finsiel group of 11 million, referring only to the first six months of 2005 (net loss of 7 million in 2004);
- net income of TIM Hellas of 11 million, referring only to the first five months of 2005 (net income of 82 million in 2004);
- net loss of TIM Perù of 3 million, referring only to the first seven months of 2005 (net loss of 17 million in 2004);
- net income of Gruppo Buffetti of 1 million (unchanged compared to 2004);
- net income of Corporacion Digitel of 20 million (net loss of 7 million in 2004).

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Net income increased by 856 million (or 30.2%), from 2,834 million in 2004 to 3,690 million in 2005. Such increase was principally due to lower income taxes on income from continuing operations (259 million), as well as the increase of Net income from Discontinued operations / Assets held for sale (668 million).

Net income attributable to Minority interests was 474 million in 2005 (1,019 million in 2004), while net income attributable to the Group was 3,216 million in 2005 (1,815 million in 2004). The main reason for the lower amount attributable to minority interests was the acquisition by Telecom Italia of the minority interests in TIM.

5.5.6 RESULTS OF OPERATIONS OF BUSINESS UNITS FOR THE YEAR ENDED DECEMBER 31, 2005 COMPARED WITH THE YEAR ENDED DECEMBER 31, 2004.**v WIRELINE**

The following table sets forth, for the periods indicated, certain financial and other data for the Wireline Business Unit.

<u>Wireline</u>	<u>Year ended December 31,</u>	
	<u>2004(1)</u>	<u>2005(2)</u>
	(millions of Euro, except percentages and employees)	
Gross revenues	17,431	17,802
Operating income	4,756	4,566
% of gross revenues	27.3	25.6
Number of employees at year-end	54,090	55,990

(1) The data relating to 2004 have been reclassified and presented consistent with the 2005 presentation.

(2) The data include those of the Internet activities (Tin.it and Matrix) acquired from Telecom Italia Media on June 1, 2005 as well as the IT Telecom activities that were transferred in part to Wireline.

The following table sets forth, for the periods indicated, certain statistical data for Wireline.

	Year ended December 31,	
	2004	2005
Subscription and Customers:		
Subscriber fixed-lines at year-end in Italy (thousands)(1)	25,957	25,049
Subscriber fixed-line growth per annum in Italy (%)	(2.4)	(3.5)
ISDN equivalent lines at year-end in Italy (thousands)(2)	5,805	5,459
Broadband Access(3):		
• in Italy (thousands)	4,010	5,707
• in Europe (thousands)	420	1,313
Voice Offers in Italy (thousands)(4)	5,883	6,392
Wireline Traffic:		
Wireline total traffic (Retail and Wholesale) (billions of minutes)	192.0	185.1
<i>of which:</i>		
<i>National(5)</i>	179.1	171.3
<i>International(6)</i>	12.9	13.8
Retail Traffic(7):		
Average minutes of use per fixed-line subscriber in Italy during period(8)	3,935	3,722
<i>of which:</i>		
<i>Local traffic during period (in average minutes)(9)</i>	2,749	2,530
<i>Long distance traffic during period (domestic and international) (in average minutes)</i>	1,186	1,192

(1) Data include multiple lines for ISDN and excludes internal lines.

(2) Data exclude internal lines.

(3) Number of contracts.

(4) Number of contracts; data include Teleconomy, Hellò and other Business voice offers.

(5) Data include total retail traffic (international outgoing traffic excluded) and total domestic wholesale traffic. Data exclude the traffic of Tin.it and Matrix.

(6) Data include international retail outgoing traffic and total international wholesale traffic.

(7) Retail traffic consists of traffic from Telecom Italia customers for local calls, long distance national and international calls and calls to mobile phones.

(8) Includes total retail fixed outgoing traffic (including international outgoing traffic and fixed outgoing traffic to the mobile networks).

(9) Includes district and Internet dial-up traffic.

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Gross Revenues increased by 371 million, or 2.1%, from 17,431 million in 2004 to 17,802 million in 2005.

This positive performance was achieved largely as the result of the success of efforts to develop the Broadband market and innovative services, particularly Web services, and to further develop the European Broadband Project, together with efforts to defend the core Wireline market for telephone services and enhance the range of wholesale services.

Wireline tracks revenues in the following business areas: Retail Telephone, Retail Internet, Data Business, European Broadband Project and Wholesale Services.

- **Retail Telephone.** Revenues from Retail Telephone were 10,095 million in 2005, a decrease of 496 million, or 4.7% from 10,591 million in 2004. Retail Telephone services consist mainly of services offered using traditional technology (PSTN and ISDN). Retail Telephone revenues consist mainly of traffic revenues, fee revenues and sales revenues: traffic revenues are directly related to traffic volumes, tariffs and fees for tariff packages; fees are attributable to access fees, fees for additional services and for equipment rental and assurance; sales revenues are related to sales of equipment (telephones).

This business area was marked by a decrease in traffic revenues due to the migration of volumes to the mobile network, partly due to competitive on-net rates (mobile to mobile calls between customers of the same operator), countered by the continuous growth of Value-Added Services (VAS) and the rapid spread of innovative handsets.

The Wireline Business Unit has implemented various strategies to limit the impact of increasing competition, such as strategies designed to retain customers, minimize the impact of tariff reductions, develop traffic and value added services usage through innovative handsets.

The strategy of building customer loyalty continues to be the primary aim of the marketing strategy: through the Teleconomy and Hellò offers and packages for traffic calls, the Wireline Business Unit continued to focus on retention and loyalty policies, specifically for the mass market. Selective marketing strategies have also been adopted for high value customers; Flat Voice Offers (Teleconomy offers and other business customized offers) had approximately 6.3 million users at the end of 2005 compared to 5.9 million users at the end of 2004.

Innovative handsets (Aladino cordless phones and phones for videocommunication) are the main targets in the commercial structures: Aladino cordless phones provide users with an increasing variety of functions that can support innovative services; videocommunication phones are specifically set for video calls. During 2005, the Wireline Business Unit sold or leased approximately 2,260,000 innovative handsets (during 2004 approximately 1,555,000 units were sold or leased).

- **Retail Internet.** Revenues from Retail Internet were 1,197 million in 2005, an increase of 176 million, or 17.2% from 1,021 million in 2004. Revenues from Retail Internet consist primarily of revenues from ADSL (mass market broadband access) for access fees and traffic, and revenues from Internet dial-up traffic revenues. Revenues from ADSL (including revenues from Portal services) were approximately 865 million, increasing strongly by 40%

compared to 2004 (618 million in 2004), mainly due to the larger customer base and traffic. Revenues from Internet dial-up traffic decreased from 403 million in 2004 to 332 million in 2005 due to migration to Internet connections using broadband access.

- **Data Business.** Revenues from Data Business (Data services, Leased Lines for retail customers, Value added services related to Data and Data Equipment) were 2,107 million in 2005, an increase of 125 million, or 6.3% from 1,982 million in 2004. Data services consist primarily of data transmission and network services for business customers. Leased lines are trunk lines offering a customer-subscriber a permanent connection for telecommunication services between two geographically separate points. This kind of connection can be used to handle high volume voice, data or video transmission. Revenues from data services are included primarily in fixed subscription and connection fees.

The growth in services revenues was driven mainly by value added services (web services, outsourcing and security services) and by innovative data services: VAS increased by 25.3% in 2005 compared to 2004 (550

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million in 2005 and 439 million in 2004); innovative data services increased by 15.7% in 2005 compared to 2004 (723 million in 2005 and 625 million in 2004).

Revenues from traditional Data services (data transmission using data packet technology) and leased lines decreased from 620 million in 2004 to 553 million in 2005 (a decrease of 10.8%), mainly due to customer migration to broadband services and repricing.

Revenue from Data equipment decreased to 281 million in 2005 from 298 million in 2004 (a decrease of 5.7%).

- **European Broadband Project.** Revenues from the European Broadband Project (France, Germany and The Netherlands) were 566 million in 2005 an increase of 109.6% compared to 2004. The European Broadband Project was given a further boost in growth by the purchase of Liberty Surf Group in France on May 31, 2005. Wireline s overall portfolio of European broadband customers at December 31, 2005 is 1,313 thousands (an increase of 893 thousands compared to 2004), while total customers, including narrow-band, were 1,791 thousands.
- **Wholesale Services.** Revenues from Wholesale Services were 3,525 million in 2005, an increase of 336 million, or 10.5% compared to 2004 (3,189 million in 2004). Wholesale Services consist of national and international services to other domestic and international operators. Services offered to other domestic operators (wireline and wireless operators as well as Internet service providers) consist mainly of interconnection to Telecom Italia s network, in terms of access and traffic (carried traffic and transits); broadband access (ADSL and XDSL access), and leased lines. Services offered to international operators consist mainly of traffic (carried traffic and transits) and data access.

Revenues from International Wholesale services increased by 240 million (or 18%) due to significant volumes of traffic carried to other operators, while revenues from Domestic Wholesale services increased by 96 million (or 5.1%) due to continued growth in Data offers, especially broadband, and LLU services.

In 2005 total **Wireline traffic revenues** decreased from 7,995 million in 2004 to 7,835 million due to a reduction of 427 million attributable to retail traffic, partly offset by an increase of 267 million attributable to wholesale traffic. The decrease in retail traffic revenues was a result of:

- commercial policies aimed at customer retention with offers (mainly Teleconomy) which provide discounted tariffs with a monthly fee; such effect was partly offset by growth in Value Added Services and ADSL traffic, boosted by the success of Alice offers (ADSL access for mass market) that is now replacing traditional Internet traffic (Internet dial-up traffic); and
- a fall in traditional traffic (Voice and Internet dial-up traffic) due to continued price reductions and volume losses pushed by competition and migration of traffic to the mobile networks.

Revenues from wholesale domestic traffic increased mainly due to transit traffic carried for other operators due to higher prices charged to some important OLOs for call termination; revenues from international wholesale traffic increased as well due to growth in traffic volumes, especially in traffic carried.

The number of subscriber fixed lines in Italy decreased by 3.5% to approximately 25.0 million as of December 31, 2005 (approximately 26.0 million as of December 31, 2004), representing a telecommunications density (fixed line subscribers to total population of Italy) of approximately 45% at December 31, 2005. The decrease in fixed lines is due to the substitution of fixed lines with mobile lines and the replacement of ISDN lines with ADSL lines. Such decrease takes into account the number of ISDN lines (approximately 5.5 million lines at the end of 2005 compared to approximately 5.8 million lines at the end of 2004). Lines include approximately 17 million residential lines (including multiple lines for ISDN), approximately 7.8 million business lines (including multiple lines for ISDN), and approximately 191,000 public telephones lines (including ISDN equivalent lines).

As of December 31, 2005, Wireline had contracts in Italy for approximately 5.7 million broadband points of access (approximately 4.0 million at the end of 2004) with approximately 890,000 wholesale points of access (599,000 at the end of 2004) and approximately 4.8 million retail market points of access (approximately 3.4 million at the

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end of 2004). The growth is attributable to the success of various tariff structures geared to the Mass Market (Alice) and to business customers. As of December 31, 2005, Wireline had approximately 1.3 million contracts for broadband access outside of Italy (420,000 as of December 31, 2004).

The contribution of the Wireline Business Unit to our consolidated revenues amounted to 15,844 million in 2004 and 16,348 million in 2005.

Operating income decreased by 190 million, or 4.0%, from 4,756 million in 2004 to 4,566 million in 2005, and was negatively impacted, among other things, by an increase in depreciation and amortization charges mainly as a result of the increase in capital expenditures for the European Broadband Project.

Operating margin decreased to 25.6% in 2005 compared to 27.3% in 2004.

V MOBILE

The following table sets forth, for the periods indicated, certain financial and other data for Mobile.

Mobile	Year ended December 31,	
	2004	2005
	(millions of Euro, except percentage and employees)	
Gross revenues	11,712	12,963
Operating income	3,850	3,661
% of gross revenues	32.9	28.2
Number of employees at year-end	18,743	20,767

The following table sets forth, for the periods indicated, certain Domestic Mobile statistical data.

Year ended December 31,

	<u>2004</u>	<u>2005</u>
Mobile lines in Italy at period-end (thousands)(1)	26,259	28,576
Mobile lines growth per annum in Italy (%)	0.7	8.8
Average revenue per mobile line per month () (2)	29.9	29.3
Cellular penetration at year-end (Italian Mobile customers per 100 inhabitants)(%)	45.5	49.1
Cellular market penetration at year-end (Italian Mobile customers for the entire market per 100 inhabitants)(%)	109.0	123.5
Total Mobile outgoing traffic per month, in Italy (millions of minutes)	<u>2,211</u>	<u>2,314</u>

(1) Includes lines of TACS, GSM and UMTS services, including Prepaid Customers, and excludes silent lines.

(2) Including Prepaid Card revenues and non TIM customer traffic revenues and excluding equipment sales.

Gross revenues increased by 1,251 million, or 10.7%, from 11,712 million in 2004 to 12,963 million in 2005.

Excluding the positive effect of changes in exchange rates (486 million), growth was 6.3% (765 million); such increase was primarily due to the positive growth of operations of the TIM Brasil group (an increase of 616 million or 34.2%) and the confirmation of the good trend on the domestic mobile market (an increase of 153 million).

The contribution of the Mobile Business Unit to our consolidated revenues was 11,457 million in 2004 and 12,672 million in 2005.

Operating income decreased by 189 million, or 4.9%, from 3,850 million in 2004 to 3,661 million in 2005.

Operating margin decreased from 32.9% in 2004 to 28.2% in 2005.

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The decline in operating income was mainly attributable to certain increased costs, including:

- purchases of materials and external services of 6,337 million in 2005, an increase of 12.2% compared to 2004 (5,650 million). The ratio of such purchases to revenues was 48.9% (48.2% in 2004);
- personnel costs were 708 million in 2005 an increase of 12.2% compared to 2004 (631 million); they included 28 million for non-employee staff (25 million in 2004). The increase in personnel costs was principally due to higher average number of employees, as well as restructuring costs (33 million). The percentage of personnel costs to revenues was 5.5% in 2005 (5.4% in 2004);
- other operating expenses were 640 million in 2005 (430 million in 2004) and included miscellaneous expenses (466 million), which were mainly attributable to indirect taxes of the Brazilian subsidiaries, impairments and losses on receivables (150 million) and other items (25 million);
- depreciation and amortization charges were 1,870 million in 2005 (1,550 million in 2004) and increased by 320 million or 20.6% compared to 2004 mainly due to the Brazilian operations (an increase of 265 million). Such increase was due to continuous capital expenditures for the expansion of network infrastructures and to support the business. Depreciation and amortization as a percentage of revenues were 14.4% in 2005 (13.2% in 2004).

Mobile Italy

The following table sets forth, for the periods indicated, certain financial and other data for the Mobile Business Unit in Italy.

Mobile Italy	Year ended December 31,	
	2004	2005
	(millions of Euro, except percentages and employees)	
Gross revenues	9,923	10,076
Operating income	4,010	3,856
% of gross revenues	40.4	38.3
Number of employees at year-end	11,767	11,720

Gross revenues in 2005 were 10,076 million, an increase of 1.5% over 2004 (9,923 million). Contributing, in particular, to the increase in revenues was the strong growth in VAS (value-added services), up 15.4% to 1,449 million compared to 2004, due to

the continuing innovation of services and the portfolio of plans and packages. The percentage of VAS revenues to total revenues was 14.4% (12.7% in 2004). Revenues of the core business (voice services), amounting to 7,921 million, were adversely affected by the impact of the new termination price list which came into effect in 2005. Excluding this impact, these revenues would have decreased by only 0.1% compared to 2004. A sharp increase was recorded in 2005 for sales of mobile handsets, with sales of 706 million (a 23.9% increase), which was due to the success of the promotional campaign for the third-generation cell phones.

Mobile lines in Italy increased to approximately 28.6 million at December 31, 2005 (including TACS lines), an increase of 8.8% compared to December 31, 2004. Total GSM and UMTS lines increased by 9.4% in 2005, to approximately 28.5 million lines at December 31, 2005, while Mobile Italy's total TACS lines decreased to 94,000 lines at December 31, 2005, in each case compared to December 31, 2004. TACS service terminated on December 31, 2005. The continuing growth in GSM/UMTS lines was attributable principally to the development of UMTS service offers and the enhanced availability of third generation handsets. The UMTS and GSM TIM Card (a prepaid rechargeable UMTS and GSM card), remained important with approximately 25.3 million lines by December 31, 2005 compared to approximately 23.2 million lines at December 31, 2004. Prepaid lines (GSM/UMTS and TACS) grew by 8.4% in 2005.

At December 31, 2005, Mobile Italy had a market share of approximately 40.0% (including GSM/UMTS and TACS) compared to the approximately 42% at December 31, 2004, and a market share of approximately 39.9% for GSM/UMTS only compared to 41.4% in 2004. The overall market grew by 13.2% in 2005 from approximately

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63.2 million mobile lines at the end of 2004 to 71.5 million mobile lines at the end of 2005. The aggregate number of customers at December 31, 2005 for Mobile Italy's analog and GSM/UMTS services represented a penetration rate of 49.1% compared to 45.5% at December 31, 2004. In 2005, Mobile Italy had a 29.0% market share of net additional GSM/UMTS lines, corresponding to 2.4 million of net lines, compared to 1.6 million for Vodafone Omnitel, 1.6 million for Wind and the remaining 2.8 million attributable to H3G(3).

In 2005, Mobile Italy traffic volumes increased by 3.3% in terms of minutes compared to 2004, while Mobile Italy voice services revenues, net of the impact of the new termination price list, decreased by 0.1% in 2005 compared to 2004. The average monthly revenue per Italian mobile line (ARPU) (which includes traffic and VAS revenues) decreased from approximately 29.9 in 2004 to 29.3 in 2005 (including service revenues from non TIM customers).

Mobile Italy revenues from equipment sales increased by 23.9% in 2005 compared to 2004 (706 million against 570 million in 2004). In particular handset volumes increased by 26% due to the summer and Christmas campaigns and the launch of EDGE/UMTS services.

Mobile Italy subscription fees decreased by 24.4% in 2005 compared to 2004 (99 million in 2005 against 131 million in 2004) due to a change in contractual conditions, in order to reach a rebalancing among subscription fees and tariffs.

Due to increasing competition on the Italian market Mobile Italy's churn rate increased to 1.4% per month in 2005 compared to 2004. The churn rate represents the number of domestic Mobile customers whose service was discontinued during that period due to a payment default or who voluntarily gave up a mobile telephony service during that period, expressed as a percentage of the average number calculated on an annual base of customers during that period. The monthly churn rate is calculated by dividing the annual rate by 12.

Operating income decreased by 154 million, or 3.8%, from 4,010 million in 2004 to 3,856 million in 2005. Such decrease reflected the significant increase in depreciation and amortization charges due to recent investments for the development of third-generation network infrastructures and to support the evolution of plans and packages for new services.

Operating margin decreased to 38.3% in 2005 compared to 40.4% in 2004.

Brazil

The following table sets forth, for the periods indicated, certain financial and other data for the Mobile Business Unit in Brazil.

Mobile Brazil	Year ended December 31,	
	2004	2005
	(millions of Euro, except percentages and employees)	
Gross revenues	1,798	2,900
Operating loss	(129)	(190)
% of gross revenues	(7.2)	(6.5)
Number of employees at year-end	6,939	9,043

Gross revenues were 2,900 million in 2005 compared to 1,798 million in 2004, an increase of 1,102 million, or 61.3%. The increase was due to the growth in the customer base, the contribution made by value-added services (which rose from 3.2% of revenues in 2004 to 5% in 2005) and revenues from voice traffic.

The TIM Brasil group, the sole operator to have nationwide coverage, is the market leader in the GSM market with 16.6 million mobile lines at December 31, 2005 (an increase of 88.7% compared to December 31, 2004). Total mobile lines at December 31, 2005 were 20.2 million of which more than 82.3% use GSM technology. This was an increase of 6.6 million lines since the beginning of the year (an increase of 48.4%). The TIM Brasil group, with a

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market share of 23.4%, ranks second nationally in terms of the number of customers and is the leader for additional market share (32.0% market share of net additions).

Operating loss in 2005 was 190 million compared to 129 million in 2004, an increase of 61 million. The increased loss was due to the increase in depreciation and amortization mainly related to the capital expenditures for the development of network infrastructures and information systems consistent with the significant growth in the business.

V MEDIA

The following table sets forth, for the periods indicated, certain financial and other data for the Media Business Unit.

Media	Year ended December 31,	
	2004	2005
	(millions of Euro, except percentage and employees)	
Gross revenues	168	180
Operating loss	(93)	(130)
% of gross revenues	(55.4)	(72.2)
Number of employees at year-end	1,077	886

Gross revenues increased by 12 million, or 7.1%, from 168 million in 2004 to 180 million in 2005. Excluding the impact of the change in the scope of consolidation (with reference to GPP Group, Televoice and Databank) equal to 24 million in 2004, as well as the start-up activities relating to the Digital Terrestrial Television of La7 (sales of pay-per-view events and smart cards) equal to 12 million in 2005, growth was 24 million, or 16.7%, from 144 million in 2004 to 168 million in 2005. In particular:

- revenues from the Television business area, including revenues for Digital Terrestrial Television, increased by 35 million, or 25.4%, from 138 million in 2004 to 173 million in 2005, confirming the editorial success of the program schedule of the two TV networks. In detail:
 - revenues from La7 Televisioni, increased by 40.3%, from 62 million in 2004 to 87 million in 2005; and
 - revenues from MTV, increased by 16.2%, from 80 million in 2004 to 93 million in 2005;

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- revenues from the News area, equal to 7 million in 2005 and 5 million in 2004, increased by 2 million, or 40%.

The contribution of the Media Business Unit to our consolidated revenues amounted to 176 million in 2005 and 165 million in 2004.

Operating loss increased by 37 million (a loss of 130 million in 2005 compared to a loss of 93 million in 2004). Such increase was principally due to the Television area where losses increased by 41 million, from a loss of 60 million in 2004 to a loss of 101 million in 2005, mainly due to higher costs incurred for digital terrestrial testing during 2005. Moreover, operating profit was affected by higher costs and investments in content required to support audience growth.

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The following table sets forth, for the periods indicated, certain financial and other data for the Olivetti Business Unit.

Olivetti(1)	Year ended December 31,	
	2004	2005
	(millions of Euro, except percentage and employees)	
Gross revenues	590	452
Operating income (loss)	17	(38)
% of gross revenues	2.9	(8.4)
Number of employees at year-end	2,109	1,750

(1) On April 5, 2005, Olivetti Tecnost S.p.A. was renamed Olivetti S.p.A..

Gross revenues decreased by 138 million, or 23.4%, from 590 million in 2004 to 452 million in 2005. Excluding the negative foreign exchange effects and the impact of the change in the scope of consolidation (with particular reference to the closing of operations in the U.S.A. and Mexico and the sale of Innovis S.p.A. and Cell-Tel S.p.A.) which represented 70 million in revenues, the revenues from the sale of intellectual property to Telecom Italia for 9 million and revenues from the start-up activities relating to the new products of the Office Division for 4 million, revenues decreased by 81 million (or 15.3%). Such decrease, in particular, was due to the decrease from Office Division (a decrease of 56 million), and Gaming and Service Automation & Specialized Printers Products (a decrease of 23 million).

In 2005, gross revenues included 256 million from Office Products, 157 million from Gaming and Service Automation & Specialized Printers Products, 36 million from the sale of intellectual property to Telecom Italia and 3 million related to other activities. Such revenues were distributed as follows: 266 million related to hardware, 101 million to accessories, 85 million to services and other revenues.

The contribution of the Olivetti Business Unit to our consolidated revenues was 400 million in 2005 and 536 million in 2004.

Operating income decreased by 55 million (a loss of 38 million in 2005 compared to an income of 17 million in 2004) principally due to the above mentioned decrease in revenues.

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5.6 LIQUIDITY AND CAPITAL RESOURCES**5.6.1 LIQUIDITY**

The Telecom Italia Group's primary source of liquidity is cash generated from operations and its principal uses of funds are the payment of operating expenses, capital expenditures and investments, the servicing of debt, the payment of dividends to shareholders and strategic investments, such as international acquisitions.

The table below summarizes, for the periods indicated, the Telecom Italia Group's cash flows.

	2004	2005
	(millions of Euro)	
Cash flows generated by operating activities	10,266	9,936
Cash flows used in investing activities	(4,951)	(17,579)
Cash flows generated by (used in) financing activities	(1,714)	8,767
Cash flows generated by (used in) discontinued operations/assets held for sale	(109)	26
Aggregate cash flows (A)	3,492	1,150
Net cash and cash equivalents (*) at the beginning of the year (B)	5,211	8,667
Net effect of foreign currency translation on net cash and cash equivalents (C)	(36)	141
Net cash and cash equivalents (*) at the end of the year (D=A+B+C)	8,667	9,958

(*) For details please see Consolidated Statements of Cash Flows for the years ended December 31, 2004 and 2005, in the Consolidated Financial Statements included elsewhere in this Annual Report.

Cash flows generated by operating activities. Cash flows generated by operating activities were 9,936 million in 2005, a decrease of 330 million compared to 2004 (10,266 million). This decrease was primarily attributable to:

- the decrease in impairment losses on non-current assets (including equity investments) of 443 million (446 million of losses in 2004 compared to 3 million of losses in 2005);
- the increase in net realized gains on disposal of non-current assets (including equity investments) of 221 million (a net gain of 106 million in 2004 compared to a net gain of 327 million in 2005);
- the reduced increase in trade payables of 737 million (an increase of 1,079 million in 2004 compared to an increase of 342 million in 2005);

- the decrease in share of earnings of equity investments accounted for using the equity method of 28 million (from net earnings of 5 million in 2004 to a net loss of 23 million in 2005);
- the effect of change in other operating assets/liabilities of 327 million (a negative contribution of 30 million in 2004 compared to a negative contribution of 357 million in 2005).

Such negative effects were largely offset by:

- an increase of 188 million in net income from continuing operations (income of 2,952 million in 2004 compared to income of 3,140 million in 2005);
- an increase in depreciation and amortization of 424 million (from 4,808 million in 2004 to 5,232 million in 2005);
- an additional decrease in deferred tax assets, net, equal to 223 million (a reduction of 1,124 million in 2004 compared to a reduction of 1,347 million in 2005);
- an additional increase of 294 million in employee severance indemnities and other employee-related reserves (a reduction of 39 million in 2004 compared to an increase of 255 million in 2005);
- an additional decrease in trade receivables of 278 million (a decrease of 51 million in 2004 compared to a decrease of 329 million in 2005).

Cash flows used in investing activities. Cash flows used in investing activities were 17,579 million in 2005 and increased by 12,628 million compared to 2004 (4,951 million) mainly as a result of:

- capital expenditures that amounted to 5,173 million in 2005, an increase of 171 million (5,002 million in 2004); in 2005 capital expenditures included 1,785 million for acquisition of intangible assets (1,882 million in 2004) and 3,388 million for acquisition of tangible assets (3,120 million in 2004);

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- acquisition of equity investments in subsidiaries and businesses, net of cash acquired, that amounted to 390 million in 2005, an increase of 389 million (1 million in 2004), mainly related to the purchase of the controlling interest in the French company Liberty Surf Group and the acquisitions of Elefante TV and Delta TV;
- acquisition of other equity investments that increased by 13,677 million in 2005 from 867 million in 2004 to 14,544 million in 2005; such increase was principally due to the consideration paid for the cash tender offer for the TIM shares (13,804 million) and for further purchases of TIM shares (28 million) in connection with acquiring the minority interests in TIM held by the public;
- a net increase in financial receivables and other financial assets of 474 million in 2005 compared to a net decrease of 424 million in 2004, with a total negative effect of 898 million in 2005 cash flows.

Such negative effects were largely offset by:

- consideration received for the sale of equity investments in subsidiaries, net of cash disposed of, that amounted to 2,052 million in 2005 (43 million in 2004), and was principally related to the disposals of Entel Chile, TIM Hellas, Finsiel and TIM Perù;
- consideration received for the sale of tangible, intangible and other non-current assets and capital reimbursements that increased by 498 million.

Cash flows generated by (used in) financing activities. Cash flows generated by financing activities in 2005 were 8,767 million, compared to cash flows of 1,714 million used in 2004 (an increase of 10,481 million).

Cash flows generated in financing activities in 2005 of 8,767 million reflected mainly the following:

- an increase in financial liabilities (current and non-current portion included) of 11,153 million, mainly as a result of the additional debt incurred in connection with the cash tender offer for the TIM shares;
- the consideration received for equity instruments of 102 million;
- a net decrease in share capital, net of related costs, of 160 million;
- the payment of dividends to minority shareholders (distribution of reserves included) of 2,328 million.

Cash flows used in financing activities in 2004 of 1,714 million reflected mainly the following:

- an increase in financial liabilities (current and non-current portion included) of 822 million;
- the consideration received for equity instruments of 193 million;
- a net increase in share capital, net of related costs, of 51 million;
- the payment of dividends to minority shareholders (distribution of reserves included) of 2,780 million.

Cash flows generated by (used in) discontinued operations/assets held for sale. Cash flows generated by discontinued operations/assets held for sale were 26 million in 2005, compared to cash flows used of 109 million in 2004.

5.6.2 CAPITAL RESOURCES

Net Financial Debt

Net Financial Debt is a non-GAAP financial measure as defined in Item 10 of Regulation S-K under the 1934 Act. For further details please see 5.5.2 Non-GAAP Financial Measures .

On a consolidated basis, at December 31, 2005, Net Financial Debt was 39,858 million compared to 32,862 million at December 31, 2004 (an increase of 6,996 million). Net Financial Debt included 106 million related to the discontinued operations/assets held for sale as of December 31, 2005 (104 million as of December 31, 2004).

We are targeting to reduce our net financial debt at year-end 2007 to approximately 33.5 billion. We intend to reach this goal through significant cash flow generation, combined with investments in innovation, and net proceeds from further disposals of non-core assets while at the same time meeting an increase in our dividend policy.

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Please see Introduction Cautionary Statement for Purposes of the Safe Harbor Provisions of the United States Private Securities Litigation Reform Act of 1995 , included elsewhere in this Annual Report, for a discussion of factors which would cause our actual results to differ materially from the target discussed above. See, also, Item 3. Key Information 3.1 Risk Factors .

There can be no assurance that we will be able to achieve the financial target we have established.

Net Financial Debt is detailed in the following table:

	As of December 31,	
	2004	2005
	(millions of Euro)	
GROSS FINANCIAL DEBT		
Non-current financial liabilities (Long-term debt)		
Financial payables	36,862	40,252
Finance lease liabilities	1,860	1,894
Other financial liabilities	3	
	38,725	42,146
Current financial liabilities (Short-term debt), excluding financial debt relating to discontinued operations/assets held for sale		
Financial payables	4,168	9,572
Finance lease liabilities	227	234
Other financial liabilities	5	6
	4,400	9,812
Financial debt relating to discontinued operations/assets held for sale	188	143
TOTAL GROSS FINANCIAL DEBT (A)	43,313	52,101
FINANCIAL ASSETS		
Non-current financial assets		
Securities other than equity investments	7	8
Financial receivables and other non-current financial assets	386	988
	393	996
Current financial assets, excluding financial assets relating to discontinued operations/assets held for sale		
Securities other than equity investments	457	378
Financial receivables and other current financial assets	662	509
Cash and cash equivalents	8,855	10,323

	<u>9,974</u>	<u>11,210</u>
Financial assets relating to discontinued operations/assets held for sale	84	37
TOTAL FINANCIAL ASSETS (B)	10,451	12,243
NET FINANCIAL DEBT (A-B)	32,862	39,858

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The following chart summarizes the major components which had an impact on the change in Net Financial Debt during 2005 (in millions of Euro):

In particular:

- the cash out of 13,832 million related to the price paid under the Cash Tender Offer, at the end of January 2005, for the purchase of 2,456,501,605 TIM ordinary shares tendered (equal to approximately 29.0% of TIM ordinary share capital) and 8,463,127 TIM savings shares tendered (equal to approximately 6.4% of TIM savings share capital) and the subsequent purchase of 5,063,893 TIM ordinary and savings shares (equal to approximately 3.8% of TIM savings share capital). Following the above mentioned transactions the stake in TIM increased by 28.7%;
- other financial investments, equal to 1,102 million, were principally related to the Liberty Surf group acquisition (259 million, net of the acquired liquidity and including the related transaction costs), financial investments in Turkey (Avea and Oger Telecom, for a total amount of 300 million) and the Telecom Italia Media buy-back for the reorganization of the Internet Business Unit (148 million), the reorganization of the shareholding in Mediterranean Nautilus group (135 million), the purchase of Elefante TV and Delta TV business by the Media Business Unit (128 million) and the ancillary costs linked to the Cash Tender Offer on TIM s shares (98 million) and other financial investments (34 million);
- capital expenditures, equal to 5,173 million, increased by 171 million compared with 2004; such increase was mainly related to the Wireline Business Unit;
- the sales of stakes and other disposals, equal to 3,834 million, included:
 - stakes disposals related to Entel Chile group, TIM Hellas, Finsiel, TIM Perù and C-Mobil (including the deconsolidation of the mentioned sold companies) resulted in a financial debt reduction of 2,956 million;
 - disposals of other non current activities for 232 million;
 - disposals linked to the reorganization of the shareholdings in Mediterranean Nautilus group for 78 million; and

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- real estate disposals made by the Group to the closed real estate funds Raissa and Spazio Industriale for 568 million. These disposals were part of the Group's ongoing program to realize value from its real estate portfolio.

Securitization and factoring arrangements led to an improvement in consolidated Net Financial Debt as of December 31, 2005 of 1,263 million, as follows:

	As of December 31,	
	2004	2005
	(millions of Euro)	
Securitization		648
Factoring	278	615
Total	278	1,263

The securitization program as of December 31, 2004, was included as part of the consolidated gross financial debt, while as of December 31, 2005 it has been excluded following the transfer to third parties of the deferred and subordinated purchase price of the securitized receivables (so called Deferred Purchase Price - DPP) and the deconsolidation of the Vehicle (TI Securitization Vehicle S.r.l.).

In particular, Telecom Italia signed with two high standing bank counter-parties a master agreement which provides the terms and conditions of the sale without recourse of the deferred and subordinated purchase price of the assigned receivables related to invoices issued from October 2005 to May 2006 (the last billing period for receivables which will be securitized before the total repayment of the issued securities, due in July 2006).

Gross Financial Debt

On a consolidated basis, at December 31, 2005 our gross financial debt amounted to 52,101 million (43,313 million at December 31, 2004) and included non-current financial liabilities (long-term debt) of 42,146 million (38,725 million at December 31, 2004), current financial liabilities (short-term debt) of 9,812 million (4,400 million at December 31, 2004) and financial debt relating to discontinued operations/assets held for sale of 143 million (188 million at December 31, 2004).

As of December 31, 2005 approximately 78% of our gross financial debt was denominated in Euro, while the remainder was primarily denominated in U.S. Dollars, Pound Sterling, Brazilian Reais, Japanese Yen.

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The following table sets out the currency composition of our gross financial debt (excluding discontinued operations/assets held for sale of 143 million):

	As of December 31,							
	2005				2004			
	Euro	%	Foreign currency	%	Total	%	Total	%
	(millions of Euro, except percentages)							
Long-term debt	30,791	76	11,355	97	42,146	81	38,725	90
Short-term debt (including current portion of long-term debt)	9,514	24	298	3	9,812	19	4,400	10
Total gross financial debt	40,305	100	11,653	100	51,958	100	43,125	100
Discontinued operations/assets held for sale					143		188	
Total					52,101		43,313	

In 2005, the share of our long-term debt (excluding current portion) as a percentage of total gross financial debt decreased from 90% to 81%. At December 31, 2005 approximately 34% of the long-term debt (including current portion) carried a floating rate.

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Long-term debt includes notes we have issued in order to reduce our dependence on short-term debt, extend the average life of our financial debt and expand our investor base. For this purpose, we issue long-term debt in the capital markets under, among others, the Telecom Italia Euro Medium Term Note Programme (EMTN), the Olivetti EMTN Programme, the Old Telecom Italia Global Medium-Term Notes Program (Global Note Program) and the Telecom Italia Capital Form F-3 Registration Statement, the net proceeds of which have been used to repay short-term debt.

With regard to the gross financial debt the following should be noted:

- on January 28, 2005, Telecom Italia S.p.A. paid 13,804 million in connection with the Cash Tender Offer for TIM shares as follows: 11,300 million was drawn from the 12 billion Term Loan Facility (divided into three tranches), granted on December 8, 2004 by a pool of Italian and international banks (700 million unused of Tranche A was cancelled), and 2,504 million was paid with Telecom Italia's own funds. On February 11, 2005 Tranche A was repaid in advance with cash from operating activities and cancelled. After such date, a total amount of 9 billion remained outstanding under the Facility divided into two tranches: 6 billion maturing in 36 months (Tranche B) and 3 billion maturing in 60 months (Tranche C). On August 1, 2005 a partial re-financing as well as an amendment to the Term Loan were concluded. In particular, Tranche B of this loan, equal to 6 billion and maturing in January 2008, was converted into a New Revolving loan for the same amount and with an extension of its maturity to 2012, with more favorable conditions. Tranche C, equal to 3 billion and maturing on January 2010, was amended to significantly reduce its spread, in order to reflect the new and more favorable conditions in the syndicated loan market. On October 20, 2005, 1.5 billion of the 6 billion New Revolving Facility maturing 2012 was repaid through the use of Telecom Italia's own funds (therefore 4.5 billion remained drawn under the New Revolving Facility). Following such repayment, 1.5 billion of the committed bank lines of credit relating to the 6.5 billion Revolving Facility maturing 2007 were cancelled. Therefore, a total amount of 6.5 billion remained outstanding and unused as committed bank lines of credit (1.5 billion under the New Revolving Facility maturing 2012 and 5 billion under the Revolving Facility maturing 2007).
- With regard to notes and bonds (including convertible and exchangeable notes and bonds), the following transactions during the year ended December 31, 2005 should be noted:
 - Telecom Italia S.p.A. issued three new series of notes under its 10 billion Euro Medium Term Note Programme:
 - on March 17, 2005, notes in the nominal amount of 850 million with an annual fixed-rate coupon 5.25%, issue price 99.667%, maturing on March 17, 2055;
 - on June 29, 2005 notes in the nominal amount of GBP 500 million (730 million as of December 31, 2005) with an annual fixed-rate coupon of 5.625%, issue price 99.878%, maturing on December 29, 2015;
 - on December 6, 2005 notes in the nominal amount of 1,000 million with a quarterly coupon indexed to the 3-month Euribor plus 0.53%, issue price 100%, maturing on December 6, 2012. The notes may be redeemed, at issuer's option, starting on December 6, 2010 and on every coupon date thereafter.
 - The Telecom Italia S.p.A. 2002-2022 bond, issued for subscription by Telecom Italia Group employees only, was equal to 248.3 million as of December 31, 2005 and increased by 32.6 million (215.7 million as of December 31, 2004), as a consequence of purchases/new subscription for 81.4 million and sales by bondholders for 48.8 million. The total amount available for subscription is 400 million. In accordance with the bond indenture, Telecom Italia is

the only counterpart both for buyers and sellers of the bonds.

- On June 29, 2005, Telecom Italia Finance S.A. re-opened its 800 million bond issue, 7.75% coupon, maturity 2033, listed on the Luxembourg Stock Exchange, increasing the outstanding amount by 250 million; accordingly the outstanding amount of these bonds issued was 1,050 million. The liquidity provided by the issuance of the new bonds, subscribed in full by a single investor, was entirely used to repurchase the Telecom Italia Finance S.A. 250 million, 7.77% coupon, maturity 2032, which was fully cancelled on July 21, 2005.

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- On September 28, 2005 Telecom Italia Capital S.A. issued U.S.\$2,500 million (2,119 million as of December 31, 2005) in nominal amount, in the context of issuances to be effected pursuant to a Form F-3 Registration Statement filed with the SEC on August 9, 2005 and effective as of August 30, 2005), divided into three tranches (guaranteed by Telecom Italia S.p.A.):
 - notes 2005-2010 in the nominal amount of U.S.\$700 million (593 million as of December 31, 2005), 4.875% semi-annual fixed-rate coupon, issue price 99.898%, maturing on October 1, 2010;
 - notes 2005-2011 in the nominal amount of U.S.\$400 million (339 million as of December 31, 2005), quarterly coupon indexed to the 3-month USD Libor plus 0.48%, issue price 100%, maturing on February 1, 2011; and
 - notes 2005-2015 in the nominal amount of U.S.\$1,400 million (1,187 million as of December 31, 2005), 5.25% semi-annual fixed-rate coupon, issue price 99.37%, maturing on October 1, 2015.
- On October 13, 2005 Telecom Italia Capital S.A. completed the exchange offer of the notes issued on October 6, 2004 (not registered with the SEC) in the nominal amount of U.S.\$3.5 billion, divided into three tranches (2010 Notes , 2014 Notes , 2034 Notes) with newly-issued notes registered with the SEC.

The newly-issued notes were registered under the United States Securities Act of 1933 and have the same terms and conditions as those of the corresponding unregistered notes. Both issuances are unconditionally guaranteed by Telecom Italia. The amount exchanged at the closing of the exchange offer was equal to U.S.\$3,498,520,000, of which U.S.\$1,248,845,000 related to the 2010 Notes, U.S.\$1,249,675,000 related to the 2014 Notes and U.S.\$1,000,000,000 related to the 2034 Notes. That amount represents approximately 99.96% of the nominal amount of notes issued in October 2004.

Furthermore, on December 21, 2005 the Board of Directors of Telecom Italia S.p.A. increased the amount of the Euro Medium Term Note Programme from 10 billion to 15 billion and authorized, under the same Euro Medium Term Note Programme, the issue of non-convertible notes for a maximum amount of 4.5 billion by the end of 2006.

The bond issues and new medium-long term debt financing were used to refinance all debt maturing in 2006 and part of the debt maturing in 2007, in accordance with Telecom Italia Group's target of ensuring adequate resources in order to cover debt maturing in the following 12/18 months. The above mentioned note issues also allow the Telecom Italia Group to take advantage of favorable interest rates and credit spreads, and to diversify in markets, instruments and maturities, principally in the three primary markets on which the Telecom Italia Group operates (Euro, Pound Sterling and U.S. Dollars).

In 2005 the following notes and bonds were repaid:

- on March 14, 2005 283,000 of the 2002-2005 notes issued by Telecom Italia Finance S.A. (originally Olivetti Finance N.V.S.A.) in the nominal amount of 500 million, with a quarterly coupon indexed to the 3-month Euribor plus 130 basis points. These notes provide the noteholder with an option to extend the maturity for successive periods of 21 months each for a total maximum term of 10 years (final due date March 14, 2012). Noteholders of 283,000 elected not to extend the bond maturity beyond March 14, 2005. With respect to the remaining nominal amount of notes of 499,717,000,

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Telecom Italia Finance S.A. issued new notes Telecom Italia Finance S.A. Euro 499,717,000 Guaranteed Floating Rate Extendable Notes Due 2006 , with maturity date December 14, 2006;

- on November 3, 2005, 643.4 million of convertible notes 2000-2005, 1% coupon, issued by Telecom Italia Finance S.A. (net of the repurchased notes and with premium of redemption);
- following requests for conversion of the Telecom Italia 1.5% 2001-2010 notes, convertible into Telecom Italia S.p.A. Ordinary Shares, the outstanding debt decreased during 2005 by 2,225 million (1,698 million as carrying value in accordance with IFRS).

Following the deconsolidation of TI Securitisation Vehicle S.r.l., the total amount of bonds decreased by 700 million as of December 31, 2005.

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By the end of 2005, Telecom Italia Finance S.A., a wholly-owned subsidiary of Telecom Italia S.p.A., repurchased bonds for a total nominal amount of 958 million:

- 141 million related to the 2,500 million notes issued on November 3, 2001 with a 1% annual fixed-rate coupon, maturing on November 3, 2005, redeemable at 113.40616% and exchangeable in 64.7934 Telecom Italia S.p.A. Ordinary Shares;
- 229 million related to the notes, issued in 2001, originally for an amount of 2,500 million (of which 1,964 million outstanding as of December 31, 2004) maturing on March 15, 2006, exchangeable into Telecom Italia S.p.A. or into Seat Pagine Gialle and Telecom Italia Media S.p.A. ordinary shares, 1% coupon with a redemption premium. As consequence of the cancellation of the repurchased notes on December 22, 2005 the outstanding nominal amount of notes was equal to 1,735 million (2,042 million at redemption);
- 232 million related to the notes originally issued for 3,000 million maturing on April 20, 2006, 6.375% coupon: those notes, together with those repurchased in 2004 for 255 million, were cancelled on December 22, 2005. Therefore, the outstanding nominal amount of notes was equal to 2,513 million;
- 30 million related to the notes originally issued for 1,750 million, maturing on April 24, 2007, 6.50% coupon: as a consequence of the cancellation of the repurchased notes on December 22, 2005 the outstanding nominal amount of notes was equal to 1,720 million;
- 76 million related to the notes originally issued for 1,750 million, maturing on January 24, 2008, 5.875% coupon: as a consequence of the cancellation of the repurchased notes on December 22, 2005, the outstanding nominal amount of notes was equal to 1,674 million;
- 250 million related to the notes issued on August 9, 2002, maturing on August 9, 2032, 7.77% coupon. As previously mentioned, the notes were fully repurchased on June 29, 2005 and fully cancelled on July 21, 2005.

On December 30, 2005 notes for CHF12 million (8 million) issued on June 12, 1986 were also cancelled: notes currently outstanding thus decreased from CHF100 million to CHF88 million (56 million as of December 31, 2005).

Notes purchased on the market before December 31, 2004 and not cancelled, for the total nominal amount of approximately 155 million, related to two notes (originally Telecom Italia Finance S.A. 1,100 million floating rate maturing on January 3, 2006 and Telecom Italia Finance S.A. 2,350 million 6.575% coupon maturing on July 30, 2009) resulted in the decrease of the outstanding nominal value of debt, according to IFRS principles.

Our debt due to banks was 10,108 million at December 31, 2005 (1,637 million at December 31, 2004), of which 646 million (746 million at December 31, 2004) was short-term debt, including the current portion of long-term debt.

Notes and bonds (including convertible and exchangeable notes)

As of December 31, 2005, the non-current and current portions of notes and bonds (including convertible and exchangeable notes) amounted to 37,981 million (36,224 million at December 31, 2004) and consisted of the following:

	As of December 31, 2004			As of December 31, 2005		
	Non-current portion	Current portion	Total	Non-current portion	Current portion	Total
	(millions of Euro)					
Notes and bonds	30,060	1,058	31,118	29,281	6,181	35,462
Convertible and exchangeable notes/bonds	4,290	816	5,106	476	2,043	2,519
Total	34,350	1,874	36,224	29,757	8,224	37,981

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At December 31, 2005, the nominal repayment amount for notes and bonds (including convertible and exchangeable notes) amounted to 37,219 million (36,116 million at December 31, 2004) and consisted of the following:

	<u>As of December 31,</u>	
	<u>2004</u>	<u>2005</u>
	(millions of Euro)	
Notes and bonds	30,177	34,577
Convertible and exchangeable notes	5,939	2,642
Total	36,116	37,219

At December 31, 2005, convertible and exchangeable notes, were detailed as follows:

Original	Nominal repayment amount				Maturity	Issue	Market	Market
Currency	(millions of Euro)	Coupon	New shares issuers	Issue date	date	price	price	value
						(%)	(%)	(millions of Euro)
Convertible notes issued by Telecom Italia S.p.A.								
Euro	600	1.50%	Telecom Italia S.p.A.	11/23/2001	01/01/2010	100	124.948	633
Exchangeable notes issued by Telecom Italia Finance S.A. and guaranteed by Telecom Italia S.p.A.								
Euro	2,042	1.00%	Telecom Italia S.p.A./ Telecom Italia Media S.p.A./ Seat Pagine Gialle S.p.A.	03/15/2001	03/15/2006	100	117.205	2,033
Total	2,642							2,666

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At December 31, 2005 notes and bonds were detailed as follows:

Original Currency	Amount in original currency (million)	Nominal amount of repayment in Euro (million)	Coupon (%)	Issue date	Maturity date	Issue price (%)	Market price (%)	Market value (millions of Euro)
Notes and bonds issued by Telecom Italia S.p.A.								
Euro	1,000	1,000	3M Euribor + 0.33	01/29/2004	01/30/2006 ^(°)	99.927	100.03	1,000
Euro	1,250	1,250	5.625	02/01/2002	02/01/2007	99.841	102.685	1,284
Euro	110	110	3M Euribor + 0.60	04/08/2004	03/30/2009	100	101.869	112
Euro	750	750	4.500	01/29/2004	01/28/2011	99.56	103.445	776
Euro	1,250	1,250	6.250	02/01/2002	02/01/2012	98.952	113.109	1,414
Euro	1,000	1,000	3M Euribor + 0.53	12/06/2005	12/06/2012	100	100.045	1,000
Euro	120	120	3M Euribor + 0.66	11/23/2004	11/23/2015	100	105.621	127
GBP	500	730	5.625	06/29/2005	12/29/2015	99.878	102.188	746
Euro	1,250	1,250	5.375	01/29/2004	01/29/2019	99.07	106.539	1,332
GBP	850	1,240	6.375	06/24/2004	06/24/2019	98.85	109.041	1,352
Euro	248	248	6M Euribor (base 365)	01/01/2002	01/01/2022	100	100	248
Euro	850	850	5.25	03/17/2005	03/17/2055	99.667	95.584	812
Sub -Total		9,798						10,203
Notes and bonds issued by Telecom Italia Finance S.A. and guaranteed by Telecom Italia S.p.A.								
Euro	1,045	1,045	3M Euribor + 1.25	05/29/2002	01/03/2006	99.456 ^(*)	100.046	1,045
Euro	2,513	2,513	6.375(a)	04/20/2001	04/20/2006	99.937	101.044	2,539
Euro	500	500	3M Euribor + 1.3(d)	12/14/2004	12/14/2006	100	100.045	500
Euro	1,720	1,720	6.500	04/24/2002	04/24/2007	100.911 ^(*)	104.212	1,792
Euro	1,674	1,674	5.875	01/24/2003	01/24/2008	99.937	105.106	1,759
Euro	1,500	1,500	5.15(b)	02/09/1999	02/09/2009	99.633	104.675	1,570
Euro	2,250	2,250	6.575(c)	07/30/1999	07/30/2009	98.649 ^(*)	109.650	2,467
Euro	2,000	2,000	7.25(a)	04/20/2001	04/20/2011	99.214	116.137	2,323
Euro	1,000	1,000	7.25	04/24/2002	04/24/2012	101.651 ^(*)	118.431	1,184
Euro	850	850	6.875	01/24/2003	01/24/2013	99.332	117.792	1,001
JPY	20,000	144	3.550	04/22/2002	05/14/2032	99.25	123.46	178
Euro	1,050	1,050	7.750	01/24/2003	01/24/2033	109.646 ^(*)	135.863	1,427
CHF	88	56	5.625	06/12/1986	06/12/2046	99.000	109.748	61
Sub -Total		16,302						17,846
Notes and bonds issued by Telecom Italia Capital S.A. and guaranteed by Telecom Italia S.p.A.								
USD	1,000	848	4.000	10/29/2003	11/15/2008	99.953	96.982	822
USD	1,250	1,060	4.000	10/06/2004	01/15/2010	99.732	95.461	1,012
USD	700	593	4.875	09/28/2005	10/01/2010	99.898	98.32	583
USD	400	339	3M US Libor +0.48	09/28/2005	02/01/2011	100	100.607	341
USD	2,000	1,694	5.250	10/29/2003	11/15/2013	99.742	98.167	1,663
USD	1,250	1,060	4.950	10/06/2004	09/30/2014	99.651	95.615	1,014
USD	1,400	1,187	5.25	09/28/2005	10/01/2015	99.370	97.101	1,153
USD	1,000	848	6.375	10/29/2003	11/15/2033	99.558	100.674	854
USD	1,000	848	6.000	10/06/2004	09/30/2034	99.081	96.387	817

Sub -Total	8,477	8,259
Total	34,577	36,308

Note (a), (b), (c), (d): see the following paragraph Mechanism describing how coupons change on step-up/step-down notes and bonds .

(°) On December 21, 2005, the Board of Directors of Telecom Italia S.p.A. approved the early repayment of such notes and bonds on January 30, 2006 (original by maturing on October 29, 2007).

(*) Weighted average issue price for notes and bonds issued with more than one tranche.

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Rating Triggers

At December 31, 2005, Telecom Italia had the following ratings:

	As of December 31, 2005	
	Rating	Outlook
Standard & Poor's:	BBB+	stable(1)
Moody's:	Baa2	stable
Fitch Ratings:	A	negative(2)

- (1) On March 30, 2006, Standard and Poor's revised its expectations on Telecom Italia. The rating agency changed its outlook from Stable to Negative and affirmed the BBB+ long-term rating on the company.
- (2) On April 11, 2006, Fitch Ratings downgraded Telecom Italia S.p.A.'s Issuer Default Rating (IDR) to BBB+ from A-. Following the downgrade, the Outlook was changed to Stable. The downgrade reflected Fitch's opinion that Telecom Italia's financial flexibility has been reduced as a result of the announcement of the increases in dividends.

New ratings on Telecom Italia are reported below:

S&P's		Moody's		Fitch Ratings	
Latest update March 30, 2006		Latest update December 7, 2004		Latest update April 11, 2006	
Rating	Outlook	Rating	Outlook	Rating	Outlook
BBB+	Negative	Baa2	Stable	BBB+	Stable

a) Telecom Italia Finance S.A. Euro Notes : 2,513 million, 6.375% interest, maturing April 2006 and 2,000 million, 7.25% interest, maturing April 2011

These securities carry protection for investors which would be triggered by a change in the rating assigned to Telecom Italia to below the Baa1/BBB+ ratings (by Moody's and S&P's, respectively): each downgrade in the rating by one notch by each of the two rating agencies to below the stated thresholds would cause an increase in the coupon interest by 0.25%, starting from the coupon payment date subsequent to the downgrade in the rating.

The downgrade in the rating from the thresholds is evaluated at the end of each coupon period and, on the basis of this evaluation, the interest for the next coupon is fixed; therefore, changes in the ratings during the coupon interest period would have no impact on the coupon in progress at that particular time.

Nevertheless, the relative step-up/step-down will only be applied when the rating at the end of the coupon period is different from the rating at the end of the preceding coupon period.

By virtue of this mechanism, the original coupons for these securities, respectively 6.125% and 7%, were increased by 0.25% due to a Baa2 rating assigned by Moody's in August 2003. In the case of the two securities, the increase was applied beginning from the coupon period which started in April 2004; accordingly, the coupon is equal to 6.375% for securities maturing in April 2006 and 7.25% for securities maturing in April 2011.

b) Telecom Italia Finance S.A. notes: 1,500 million, 5.15% interest, maturing February 2009

These notes carry protection for investors which would only be triggered by a downgrade in the minimum rating (among the ratings assigned by the various agencies, in this specific case, the Baa2 rating by Moody's).

At the beginning of every coupon period, this minimum rating will be checked, and depending upon the rating, the coupon interest will be fixed; once fixed, changes in the minimum rating during the coupon period will have no effect on the coupon to be paid, and will only have an impact when the next coupon interest rate is fixed (if the changes are still in effect).

Starting from the initial level of the coupon at issue (5%), a 0.15% increase in interest was granted to investors definitively up to the maturity date, bringing the current coupon interest rate to 5.15%.

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This current coupon can be further increased in relation to the level of the minimum rating:

- if at the time the coupon interest is fixed, the minimum rating is Ba1/BB+ or below, the current coupon will be increased by 1.5%;
- if at the time the coupon interest is fixed, the minimum rating is Baa3/BBB-, the current coupon will be increased by 0.5%;
- ratings higher than the minimum rating do not lead to increases in the current coupon.

Therefore, only future downgrades in the minimum rating could cause an increase in the current coupon; this coupon cannot be reduced because of upgrades in the rating.

c) Telecom Italia Finance S.A. notes: 2,250 million, 6.575% interest, maturing July 2009

These notes carry protection for investors which would be triggered by a change in the minimum rating (among those assigned by the various agencies, in this specific case, the Baa2 rating by Moody's).

At the beginning of every coupon period, this minimum rating will be checked and depending upon the rating, the coupon interest will be fixed; once fixed, changes in the minimum rating during the coupon period will have no effect on the coupon to be paid, and will only have an impact when the next coupon interest rate is fixed (if the changes are still in effect).

Starting from the initial level of interest at issue (6.125%), the coupon to be paid will be increased in relation to the level of the minimum rating:

- if, at the time the coupon is fixed, the minimum rating is Ba1/BB+ or below, the original coupon will be increased by 1.95%;
- if, at the time the coupon interest is fixed, the minimum rating is Baa3/BBB-, the original coupon will be increased by 0.95%;
- if, at the time the coupon interest is fixed, the minimum rating is Baa2/BBB, the original coupon will be increased by 0.45%;

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- if, at the time the coupon interest is fixed, the minimum rating is Baa1/BBB+, the original coupon will be increased by 0.15%;
- ratings higher than the minimum rating do not lead to increases in the original coupon.

Under this mechanism, since October 2000 (the date the mechanism was introduced), the original coupon has been increased by 0.45% (reaching the current 6.575%).

Future upgrades/downgrades in the minimum rating could cause a reduction/increase in the coupon according to the mechanism described above.

d) Telecom Italia Finance S.A. notes: 499,717,000 Floating Rate Extendable Notes (3-month Euribor + 1.3%), maturing December 2006

These bonds can be extended at the discretion of the investor. Each extension of the maturity date is for another 21-month period with the final maturity date fixed at March 14, 2012.

In accordance with the terms and conditions of the 500 million extendable notes, maturing March 14, 2005, noteholders in possession of notes totaling 283,000 chose not to extend the maturity date. For noteholders that decided to extend the maturity date, for notes totaling 499,717,000, Telecom Italia Finance S.A. issued new bonds on December 14, 2004 denominated Telecom Italia Finance S.A. 499,717,000 Guaranteed Floating Rate Extendable Notes Due 2006 with a new maturity date of December 14, 2006. These new notes carry the same characteristics as the previous notes but have a new ISIN Code and Common Code.

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Financial covenants / other covenants / other features of convertible notes and bonds

The securities summarized here do not contain either financial covenants or clauses that would force the early redemption of the bonds in relation to events other than the insolvency of the Telecom Italia Group.

For example, there are no clauses that would cause the redemption of the notes and bonds if the ratings are downgraded to below stated thresholds.

The guarantees provided by Telecom Italia S.p.A. on notes and bonds issued by its foreign subsidiaries are all full and unconditional.

None of the securities summarized here carry any other interest rate structures or structural complexities.

Since these notes and bonds have been placed principally with institutional investors on major world capital markets (Euromarket and the U.S.A.), the terms which regulate the notes and bonds are in line with market practice for similar transactions effected on these same markets.

The notes and bonds issued by Telecom Italia Capital S.A. in October 2003, guaranteed by Telecom Italia, for an amount of U.S.\$4,000 million, were covered by a covenant that required Telecom Italia Capital S.A. and Telecom Italia to effect an SEC-registered exchange offer in order to allow investors to exchange the originally purchased notes with listed and freely traded notes without restrictions. The exchange offer was executed on October 14, 2004, in fulfillment of the covenant.

Moreover, the new notes issued by Telecom Italia Capital S.A. in October 2004, guaranteed by Telecom Italia S.p.A., for an amount of U.S.\$3,500 million, carried a similar covenant which requires Telecom Italia Capital S.A. and Telecom Italia S.p.A. to effect an SEC-registered exchange offer. The offer was executed on October 13, 2005, in fulfillment of the covenant.

Bank Facilities

On December 8, 2004 Telecom Italia entered into the 12 billion Term Loan Facility, granted by a pool of domestic and international banks, in order to partially finance the TIM Acquisition.

The Term Loan Facility was divided into three tranches aggregating 12 billion, with different maturities:

- Tranche A of 3,000 million, maturing in 12 months, extendable for further 12 months;
- Tranche B of 6,000 million, maturing in 36 months, extendable for further 9 months;
- Tranche C of 3,000 million, maturing in 60 months.

On January 28, 2005, following the result of the Cash Tender Offer, the Term Loan Facility was drawn for a total amount of 11.3 billion and 0.7 billion of the Tranche A facility was cancelled.

On February 11, 2005, the residual amount of 2.3 billion of Tranche A was repaid in advance with cash from operating activities and cancelled. After such date, a total amount of 9 billion remained outstanding under the Facility, divided into two tranches: 6 billion maturing in 36 months (Tranche B) and 3 billion maturing in 60 months (Tranche C).

On August 1, 2005, a partial re-financing as well as an amendment of the Term Loan were completed. In particular, Tranche B of this loan, equal to 6 billion and maturing on January 2008, has been converted into a New Revolving loan for the same amount and with an extension of its maturity to 2012, with more favorable conditions. Tranche C, equal to 3 billion and maturing on January 2010, was amended to significantly reduce its spread, in order to reflect the new and more favorable conditions in the syndicated loan market.

The New Revolving Facility of 6 billion maturing 2012 does not contain any financial covenants and does not place any constraints on how we operate our business. The agreement includes customary representations and warranties and events of default for a revolving credit agreement of this type. However, according to the terms of the agreement, Telecom Italia Group is not required to represent that there has been no material adverse change in the business or financial condition of Telecom Italia Group at the time of any drawdown.

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On October 20, 2005, 1.5 billion of the 6 billion New Revolving Facility maturing 2012 was repaid through the use of Telecom Italia's own funds (therefore 4.5 billion remained drawn under the New Revolving Facility). Following such repayment, 1.5 billion of the committed bank lines of credit related to the 6.5 billion Revolving Facility maturing 2007 were cancelled. Therefore, a total amount of 6.5 billion remained outstanding and unused as committed bank lines of credit (1.5 billion under the New Revolving Facility maturing 2012 and 5 billion under the Revolving Facility maturing 2007).

We have a number of debt facilities available which can be summarized as follows:

- the Olivetti Euro Medium Term Note Programme, as updated and amended on June 8, 2001 and May 14, 2002, which allows for the issuance of a total amount of 15 billion in debt (or the equivalent in other currencies), at various terms, rates and maturities;
- the Global Medium-Term Notes Program, which allows for the issuance of a total amount of U.S.\$12 billion in debt (or the equivalent in other currencies), at various terms, rates and maturities;
- the 2003 EMTN Programme which allows issuances for a total amount of 10 billion in debt (or the equivalent in other currencies) in debt at various terms, rates and maturities. On December 21, 2005 the Board of Directors of Telecom Italia S.p.A. authorized both the increase of the amount of the EMTN Programme from 10 billion to 15 billion and, under the same EMTN Programme, the issue of non-convertible notes for a maximum amount of 4.5 billion by the end of 2006;
- the Form F-3 Registration Statement, filed with the Securities and Exchange Commission on August 9, 2005 and effective as of August 30, 2005 which allows issuances for a total amount of U.S.\$10 billion in debt at various terms, rates and maturities.

Debt to Equity Ratio. The Telecom Italia Group's debt to equity ratio, calculated as the ratio of consolidated net financial debt to total shareholders' equity (including minority interests), was 147.7% and 158.0% as of December 31, 2005 and December 31, 2004, respectively.

Centralized Treasury. Telecom Italia has a centralized treasury that provides financial assistance to the Telecom Italia Group, and generally operates as the Group's principal banker, allocating cash where needed and collecting the liquid resources of the members of the Group. As a result, we are able to ensure that our subsidiaries have adequate liquidity to satisfy their requirements. Telecom Italia also acts on behalf of its subsidiaries in negotiating bank lines of credit and provides financial consultancy services to its subsidiaries.

The central treasury function reduces the need for the members of the Group to utilize banks, enables members of the Group to obtain more favorable terms from banks when needed and enables us to maintain control over cash flows and to assure better utilization of surplus liquidity.

Cash Management. We utilize short-term credit lines to support expenses and disbursements that occur in the ordinary course of business, using free cash flow generated by its business to fund capital expenditures and acquisitions and to repay long-term debt.

Lines of Credit. Short-term lines of credit granted to the Telecom Italia Group by banks, according to standard money market terms and conditions, consist partly of lines of credit with specified maturities and partly of lines of credit callable upon notice. All of the Company's medium and long-term lines of credit relate to specific loans drawdown to fund the Company's activities.

Off-Balance Sheet Arrangements

Off-balance sheet arrangements refer to any transaction, agreement, or other contractual arrangement (other than contingent liabilities arising from litigation, arbitration or regulatory actions), involving an unconsolidated entity under which Telecom Italia has:

- guarantee contracts required to be initially recorded at fair value under FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45);

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- retained or contingent interests in transferred assets;
- any obligation under derivative instruments classified as equity; or
- any obligation arising out of a material variable interest in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to the company, or that engages in leasing, hedging, or research and development arrangements with the company.

As of December 31, 2005, the Telecom Italia Group had the following items that are considered to be off-balance sheet.

Purchase commitments for 316 million related mainly to:

- 210 million of property lease rentals under contracts lasting more than 6 years;
- 59 million of orders to suppliers of Telenergia relating to the electrical power supply agreements reached with Endesa for the three-year period 2004-2006.

Sale commitments for a total amount of 489 million mainly relating to:

- 431 million in respect to the agreement to sell buildings to the closed-end real estate investment funds Fondo Raissa and Fondo Spazio Industriale;
- 57 million in respect of the agreement to sell the Gruppo Buffetti S.p.A..

The purchase and sale commitments above refer to commitments that do not fall within the normal operating cycle of the Group.

As of December 31, 2005, the Group has given guarantees of 529 million, net of 474 million of counter-guarantees received, and consisted mainly of sureties provided by Telecom Italia on behalf of associated companies (of which 121 million on behalf of Avea I.H.A.S. and 142 million on behalf of other associates) and others for medium and long-term loans.

In addition, the 47.80% interest in Tiglio I and the 49.47% interest in Tiglio II have been pledged to the banks that financed the two associates.

As of December 31, 2005, Telecom Italia Group companies have also issued support letters for a total of 295 million, mainly on behalf of associates to guarantee insurance policies, lines of credit and overdraft arrangements.

For further details please see Note 25 Commitments and potential liabilities c) Commitments and other guarantees of the Notes to the Consolidated Financial Statements.

Contractual Obligations and Commitments

The following tables aggregate our contractual obligations and commitments with definitive payment terms which will require significant cash outlays in the future in terms of nominal amounts and carrying values in accordance with IFRS.

In 2006 we repaid on January 30, 2006 the Telecom Italia S.p.A. Euro 1,000,000,000 Floating Rate Notes due 2007 (originally maturing on October 29, 2007) approved by the Board of Directors of Telecom Italia S.p.A. on December 21, 2005.

The average maturity of financial non-current liabilities was equal to 7.4 years.

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As of December 31, 2005, the nominal and other amounts payable were as follows:

	Year Ended December 31,						Total
	2006	2007	2008	2009	2010	After 2010	
	(millions of Euro)						
Notes and bonds	7,100	2,970	2,521	3,860	2,253	18,515	37,219
Loans and other debts	239	595	570	216	3,104	5,466	10,190
Sub-total	7,339	3,565	3,091	4,076	5,357	23,981	47,409
Finance lease	43	41	29	20	16	13	162
Operating lease	124	90	62	40	10	10	336
Long rent	67	27	52	52	53	1,379	1,630
Total non-current financial debt	7,573	3,723	3,234	4,188	5,436	25,383	49,537
Current financial liabilities	760						760
Total	8,333	3,723	3,234	4,188	5,436	25,383	50,297
Discontinued operations/assets held for sale							142
Total							50,439

As of December 31, 2005 the carrying amounts of payables due according to IFRS (including fair value adjustment and measurement at amortized cost) were as follows:

	Year Ended December 31,						Total
	2006	2007	2008	2009	2010	After 2010	
	(millions of Euro)						
Notes and bonds	8,224	2,979	2,515	3,916	2,120	18,227	37,981
Loans and other debts	521	597	569	281	3,087	5,961	11,016
Sub-total	8,745	3,576	3,084	4,197	5,207	24,188	48,997
Finance lease	43	41	29	20	16	13	162
Operating lease	124	90	62	40	10	10	336
Long rent	67	27	52	52	53	1,379	1,630
Total non-current financial debt	8,979	3,734	3,227	4,309	5,286	25,590	51,125
Current financial liabilities	833						833
Total	9,812	3,734	3,227	4,309	5,286	25,590	51,958



Discontinued operations/assets held for sale	143
Total	52,101

For further details please see also Note 23 Financial instruments of the Notes to the Consolidated Financial Statements.

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The table below sets forth, for the periods indicated, our total capital expenditures based on the organization by Business Unit at December 31, 2005.

	Year ended December 31,	
	2004(1)(2)	2005(1)
	(millions of Euro)	
Acquisition of tangible assets:		
Wireline(3)(4)	1,320	1,866
Mobile	1,523	1,269
Media(3)	16	27
Olivetti	14	18
Other activities(4)(5)	247	208
Total acquisition of tangible assets(6)	3,120	3,388
Acquisition of intangible assets(7)	1,882	1,785
Total capital expenditures(8)	5,002	5,173

(1) All financial data exclude those relating to the consolidated companies considered as discontinued operations/assets held for sale.

(2) The data relating to 2004 have been reclassified and presented consistent with the 2005 presentation.

(3) On June 1, 2005, Telecom Italia acquired all of Telecom Italia Media's Internet activities (Tin.it and Matrix); as a result of this, the Internet activities are included in the Wireline Business Unit for all periods presented, while they have been considered as discontinued operations/assets held for sale in the Media Business Unit.

(4) The operating activity, IT Group, is no longer presented since it is now included in the Wireline Business Unit and in Other Activities following the merger of IT Telecom in Telecom Italia which took place at the end of 2004.

(5) The economic and financial results of Entel Bolivia have been included in Other activities.

(6) Acquisition of tangible assets are mainly related to local and long distance networks, exchange equipment, investment in subscribers equipment, radio and transmission equipment.

(7) Acquisition of intangible assets, include investments such as software for telecommunications systems and licenses.

(8) Intercompany capital expenditures are adjusted to eliminate intercompany profits.

In the years ended December 31, 2005 and 2004, cash flows generated by operating activities (9,936 million in 2005 and 10,266 million in 2004) exceeded capital expenditures in tangible and intangible non-current assets (5,173 million in 2005 and 5,002 million in 2004).

The capital expenditures planned for the three years 2006-2008 will be approximately in a range between 13 billion and 14 billion, as reported below:

	Capital Expenditures
	2006-2008
	(billions of Euro)
Operations in Italy	10-10.5
Operations European Broadband Project	0.8-1.0
Operations TIM Brasil	1.6-1.9
Telecom Italia Media	0.25
Other	0.35
Total Telecom Italia Group Capital Expenditures	13-14

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In particular, capital expenditures for Operations in Italy planned in a range between 10 billion and 10.5 billion for the three-year period 2006-2008 are analyzed as follows:

	Capital Expenditures for Operations in Italy 2006-2008
Wireline and mobile broadband access (ADSL, ADSL2+, VDSL, HSDPA, UMTS, UMA) and terminals	28%
Personal Communication Services (VoIP, Videocom.), Content Based Services (IPTV, DVBH, Rosso Alice), ICT VAS	23%
Operational Support System (OSS) and Business Support System (BSS) development to sustain service innovation	21%
Traditional network infrastructures	28%
Total capital expenditures for Operations in Italy (billions of Euro)	10-10.5

The Group will therefore continue the process of integrating its networks with the aim of building a sole carrier infrastructure that is completely based on IP protocol and able to support innovative broadband services both for wireline and mobile telecommunications. This infrastructure will represent the foundation for the development of a common platform on which the same products and services can be offered on any type of terminal (PC, TV, cell phone, etc.) using various technologies (Asymmetric Digital Subscriber Line (ADSL), High Speed Downlink Packet Access (HSDPA), Digital Video Broadcasting-Home (DVB-H), Unlicensed Mobile Access (UMA)) and allowing the customer to decide where, how and when to access these services. This commitment is also backed by the growing impact of the synergies originating from the integration of the Wireline-Mobile structures under the One Company Model.

For 2006, the Telecom Italia Group expects to make total capital expenditures in the order of 4.8 billion 4.9 billion.

Specifically, in Operations, planned capital expenditures are divided as follows:

- 2.7 billion for Operations-Wireline (including 0.4 billion for the European Broadband Project);
- 1.3 billion for Operations-Mobile in Italy.

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Research, Development And Innovation

5.7 RESEARCH, DEVELOPMENT AND INNOVATION

The Italian market of telecommunications is considered among the most advanced, both from the technological viewpoint and evolution of customer attitudes as well as customer consumption profiles.

Technological innovation is therefore an essential and differentiating factor permitting the Telecom Italia Group to develop a competitive advantage and maintain leadership in an increasingly competitive market.

The wealth of technological and innovative competences of the Group has allowed over the years the design, development and adoption of state-of-the-art networks, terminals and services, a wealth to be used also in foreign countries where the Group operates through subsidiaries.

Technological innovation activities are carried out also by the operational and business units (Network, Market, Information Technology, Web & Media and Security) as well as by Olivetti in addition to the Innovation & Engineering Services department (former Telecom Italia Lab) of Operations where all the activities and competences concerning basic research, the assessment of developing technologies and the intra-moenia development are concentrated.

The technological innovation of Telecom Italia Group arises moreover from the strategic partnerships with the most important manufacturers of telecommunication equipment and systems and with research centres of excellence in the most qualified academic institutions both at the national and international level.

Technological innovation activities range from reviews of basic technologies, aimed at increasing network and system efficiency, to complex activities involving the radical review of platforms, services and architectures; the effort concentrated on the field by business unit operational departments is therefore essential to assure the compliance of new services with customer needs and the continuous improvement of service quality.

During the financial year 2005, the innovative investments of Telecom Italia Group in tangible and intangible assets totaled approximately 3,700 million. Internal resources devoted to these activities as well as to research, in Italy, and Brazil, comprise approximately 5,600 employees, with an overall commitment equal to about 350 million (of which about 121 million is already included in the investments).

Total research and development costs incurred in 2005 amounted to approximately 180 million (181 million in 2004) and included external costs, labor costs of dedicated staff and depreciation and amortization.

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5.8 CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2005 RECONCILIATION OF IFRS TO U.S. GAAP

During the two years ended December 31, 2004 and 2005, the Telecom Italia Group engaged in certain significant transactions which, under U.S. GAAP, give rise to material differences in net income and shareholders' equity when compared to IFRS. In addition, the application of the IFRS first time adoption at the transition date (January 1, 2004) as well as of certain U.S. GAAP accounting principles lead to material adjustments to IFRS net income and shareholders' equity. In particular, the most significant differences arose from the following:

- business combinations prior to the adoption of IFRS;
- TIM Acquisition of minority interest in 2005;
- rationalization of the Group's Internet operations;
- sale of real estate properties (Magnum Project);
- different basis of reference for the impairment test of goodwill (Cash Generating Unit under IFRS and Reporting Unit under U.S. GAAP);
- capitalization of interest on assets under construction under U.S. GAAP (under IFRS, as permitted, Telecom Italia has elected to charge interest to the statement of operations);
- deferred taxes on tax suspension equity reserves.

As a result of the foregoing elements there are material differences for the years ended December 31, 2004 and 2005 in reconciling IFRS net income and shareholders' equity to U.S. GAAP. The following is a discussion of the U.S. GAAP treatment of such transactions and the application of the described U.S. GAAP accounting principles and the impact on net income and shareholders' equity under IFRS for the two year period ended December 31, 2005. For a complete description of the Telecom Italia Group's reconciliation and other required U.S. GAAP disclosures see Notes 43, 44 and 45 of the Notes to the 2005 Consolidated Financial Statements included elsewhere herein.

5.8.1 YEAR ENDED DECEMBER 31, 2005***Net income, net of minority interests***

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Under IFRS, net income attributable to the Group was 3,216 million in 2005, compared to net income of 1,939 million under U.S. GAAP. The decrease in net income of 1,277 million in 2005 is largely attributable to certain of the transactions as well as the application of certain of the U.S. GAAP accounting principles described above which resulted in material adjustments to the IFRS operating results. The most significant items affecting the 2005 results are as follows:

- *business combinations prior to the adoption of IFRS:* Telecom Italia elected not to apply IFRS 3 *Business Combinations*, to prior year business combinations (which mainly include Old Telecom Italia acquisitions that occurred in the period 1999-2003) as allowed by IFRS 1 *First-time Adoption of International Financial Reporting Standards*. As a result, under IFRS, certain differences relating to business combinations prior to 2004 were accounted for as a pooling of interest or on the basis of book values (for both assets acquired and shares issued). U.S. GAAP requires that the assets and liabilities purchased be recorded at fair value for all business combinations. As a result, these transactions gave rise to classes of assets, in particular tangible and intangible assets besides goodwill, that are being amortized with an increase in depreciation and amortization of 860 million. Moreover, due to the sale and leaseback of assets, 366 million of prior year purchase allocation on real estate assets has been written off on disposal of the related assets;
- *TIM Acquisition of minority interest in 2005:* during 2005, the Group acquired the outstanding minority interest in TIM through a Cash Tender Offer, other purchases in the market and the merger with and into Telecom Italia. Under IFRS such transactions were accounted for under the parent-entity extension method which gave rise to an increase in goodwill. Under U.S. GAAP, which requires the application of the purchase method and step acquisition accounting, the price allocation resulted in the recognition of a reduction of goodwill due to the allocation of the purchase price to the fair value of the Group's share of identifiable intangible assets acquired and an increase in amortization of 529 million for the year;

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- *tax effect on reconciling items:* in 2005 the additional tax benefit of 558 million recorded for U.S. GAAP related mainly to the additional amortization and depreciation expense recorded for intangible and tangible assets described above;
- *discontinued operations/assets held for sale:* an additional net loss of 175 million in 2005 was recorded under U.S. GAAP almost entirely relating to the disposal of the subsidiaries Entel Chile and TIM Perù. Such disposals led to the reversal to the statement of operations of the cumulative translation adjustments which under IFRS first time adoption were recognized only from January 1, 2004.

Shareholders Equity, net of minority interests

Shareholders equity, attributable to the Group, under IFRS was 25,662 million at December 31, 2005, compared to 44,631 million for U.S. GAAP. The overall impact of the U.S. GAAP adjustments was to increase shareholders equity net of minority interests by 18,969 million. The most significant items affecting this increase are as follows:

- *business combinations prior to the adoption of IFRS:* as explained above in more details, U.S. GAAP requires that the assets and liabilities purchased be recorded at fair value for all business combinations. As a result, these transactions gave rise to classes of assets, in particular tangible and intangible assets, that are being amortized, as well as goodwill. The application of this accounting treatment resulted in an increase of 22,592 million of the shareholders equity (gross of minority interests and taxes) as of December 31, 2005;
- *TIM Acquisition of minority interest in 2005:* as explained above in more details, under U.S. GAAP, which requires the application of the purchase method and step acquisition accounting, the price allocation resulted in the recognition of a reduction of goodwill due to the allocation of the purchase price to the fair value of the Group's share of identifiable intangible assets acquired and an increase in amortization for the year. Such accounting treatment resulted in an increase of 3,075 million of the shareholders equity (gross of minority interests and taxes) as of December 31, 2005;
- *rationalization of the Group's Internet operations:* as described in Note 4 of the Notes to the Consolidated Financial Statements, under IFRS, the acquisition of the Internet business from Telecom Italia Media was treated as a transaction among shareholders, and the difference between the price paid and the share of the underlying net assets acquired (364 million) was included as a movement of equity. Under U.S. GAAP, the acquisition has been accounted for under the purchase method and the excess of the purchase price over the share of net assets acquired was allocated to brand name, customer list and other intangibles for a total amount of approximately 285 million and to goodwill for approximately 83 million. Such different accounting treatment resulted in an increase of 346 million of the shareholders equity (gross of minority interests and taxes) as of December 31, 2005;
- *capitalization of interest:* under IFRS, Telecom Italia has elected not to capitalize interest on assets under construction. U.S. GAAP requires interest to be capitalized on both tangible and intangible assets regardless of whether specific borrowings relate to the project. The capitalized interest is amortized over the remaining useful life of the assets. A large part of the interest capitalized in previous years relates to the UMTS license of TIM which was put into use in 2004 and on which amortization expense has been calculated commencing in 2004. Such different accounting treatment resulted in an increase of 752 million of the shareholders equity (gross of minority interests and taxes) as of December 31, 2005;
- *deferred taxes on tax-suspension equity reserves:* under IFRS, IAS 12 *Income taxes*, allows, under certain conditions, not to record deferred income taxes on tax suspension equity reserves, whereas, under U.S. GAAP, SFAS

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109 *Accounting for Income Taxes* provides that deferred taxes, in any case, shall be provided. Such different accounting treatment resulted in an increase in deferred tax liability and consequently a decrease of 257 million of shareholders equity as of December 31, 2005;

- *tax effect on reconciling items:* these effects resulted in a decrease of 7,559 million in shareholders equity (gross of minority interests) as of December 31, 2005, and mainly relate to additional tangible and intangible assets (excluding goodwill) arising from the above business combinations.

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Total liabilities under IFRS were 69,025 million versus 77,327 million (excluding minority interests) for U.S. GAAP. In particular, excluding financial liabilities relating to discontinued operations/assets held for sale, non-current financial liabilities were 43,065 million under U.S. GAAP at the end of 2005, versus 42,146 million under IFRS, with an increase of 919 million under U.S. GAAP. Such increase mainly arose from:

- the different accounting treatment of some aspects of real estate transactions entered into by the Telecom Italia Group, mainly in previous years. Under IFRS, such transactions have been recorded in accordance with the finance method, except for the land element which, in absence of a contractual purchase option or passage of title to Telecom Italia, was treated as operating lease. Such accounting treatment was also followed under U.S. GAAP except for the land element which, when less than 25% of the fair value of the property, was treated as finance lease with an additional increase in debt. The additional debt amounts to 575 million;
- the application of the purchase accounting method to the Old Telecom Italia Acquisition under U.S. GAAP, which led to the valuation of liabilities at fair values and an increase of debt of 259 million.

5.8.2 YEAR ENDED DECEMBER 31, 2004***Net income, net of minority interests***

Under IFRS, net income attributable to the Group was 1,815 million in 2004, compared to net income of 1,541 million under U.S. GAAP. The decrease in net income of 274 million in 2004 is largely attributable to certain of the transactions as well as the application of certain of the U.S. GAAP accounting principles described above which resulted in material adjustments to the IFRS operating results. The most significant items affecting the 2004 results are as follows:

- *business combinations prior to the adoption of IFRS:* Telecom Italia elected not to apply IFRS 3 *Business Combinations*, to prior year business combinations (which mainly include Old Telecom Italia acquisitions that occurred in the period 1999-2003) as allowed by IFRS 1 *First-time Adoption of International Financial Reporting Standards*. As a result, under IFRS, certain differences relating to business combinations prior to 2004 were accounted for as a pooling of interest or on the basis of book values (for both assets acquired and shares issued). U.S. GAAP requires that the assets and liabilities purchased be recorded at fair value for all business combinations. As a result, these transactions gave rise to classes of assets, in particular tangible and intangible assets besides goodwill, that are being amortized with an increase in depreciation and amortization expense for the year of 978 million;
- *reversal of goodwill impairment:* to evaluate and account for impairments of depreciable assets or assets to be disposed of, the Group follows the guidance provided in SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* which provides, in particular, that carrying values shall be firstly compared with undiscounted cash flows.

Furthermore, to test for impairment goodwill is allocated, under IFRS, at the date of acquisition, to each cash-generating units or groups of cash-generating units which are expected to benefit from the acquisition. Allocation is made to the lowest level at which goodwill is monitored for management purposes, which is never at a higher level than that of the business segments determined in accordance with IAS 14 *Segment Reporting*. Under U.S. GAAP, the Group ceased amortizing goodwill on January 1, 2002, upon

the adoption of SFAS 142, *Goodwill and Other Intangible Assets*, whereas under IFRS first time adoption the Group ceased amortizing goodwill on January 1, 2004.

As explained in more details in Note 43.5 of the Notes to the Consolidated Financial Statements, in accordance with SFAS 142, the first step in the test for impairment of goodwill is to identify potential impairment by comparing the fair value of a reporting unit (which encompasses a wider meaning than cash generating unit adopted by IFRS) with its carrying amount, including goodwill. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of the loss, if any. The second part compares the implied value of the reporting unit's goodwill to the carrying amount of that goodwill. The excess of the carrying value over the implied value is then written-off in the period. Implied value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination.

As a result, certain impairment losses recorded under IFRS were deemed not necessary under U.S. GAAP and therefore have been reversed to the statement of operations with a positive effect on income of 438 million;

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- *tax effect on reconciling items:* in 2004 the additional tax benefit of 334 million recorded for U.S. GAAP related mainly to the additional amortization and depreciation expense recorded for intangible and tangible assets described above in connection with the above business combinations and acquisitions;
- *minority interest on reconciling items:* the negative impact on income in accordance with U.S. GAAP of 186 million relates mainly to the reversal of goodwill impairment as above and to other minor U.S. GAAP adjustments.

Shareholders Equity, net of minority interests

Shareholders equity, attributable to the Group, under IFRS was 16,248 million at December 31, 2004, compared to 34,827 million for U.S. GAAP. The overall impact of the U.S. GAAP adjustments was to increase shareholders equity net of minority interests by 18,579 million. The most significant items affecting this increase are as follows:

- *business combinations prior to the adoption of IFRS:* as explained above in more details, U.S. GAAP requires that the assets and liabilities purchased be recorded at fair value for all business combinations. As a result, these transactions gave rise to classes of assets, in particular tangible and intangible assets, that are being amortized, as well as goodwill. The application of this accounting treatment resulted in an increase of 23,565 million of the shareholders equity (gross of minority interests and taxes) as of December 31, 2004;
- *capitalization of interest:* under IFRS, Telecom Italia has elected not to capitalize interest on assets under construction. U.S. GAAP requires interest to be capitalized on both tangible and intangible assets regardless of whether specific borrowings relate to the project. The capitalized interest is amortized over the remaining useful life of the assets. A large part of the interest capitalized in previous years relates to the UMTS license of TIM which was put into use in 2004 and on which amortization expense has been calculated commencing in 2004. Such different accounting treatment resulted in a net increase of 786 million of the shareholders equity (gross of minority interests and taxes) as of December 31, 2004;
- *convertible notes/bonds:* under IFRS, compound financial instruments represented by notes and bonds convertible into shares of the issuer (convertible bonds) are recognized by bifurcating the debt and the call option: the debt is included in financial liabilities under the amortized cost method while the call option value, computed as the difference between the fair value of the debt and the nominal value of the financial instrument, is classified in a specific equity reserve. Under U.S. GAAP, convertible notes and bonds are recognized as debt; consequently, such different accounting treatment resulted in a decrease of shareholders equity of 378 million.

Total liabilities under IFRS were 61,036 million versus 67,206 million (excluding minority interests) for U.S. GAAP. In particular, excluding financial liabilities relating to discontinued operations/assets held for sale, non-current financial liabilities were 38,725 million under U.S. GAAP at the end of 2004, with no difference with respect to IFRS. However, certain presentation differences relating to discontinued operations/assets held for sale exist between IFRS and U.S. GAAP: IFRS does not permit the reclassification of the prior year balance sheet for discontinued operations/assets held for sale arising in the current year, while under U.S. GAAP the Group has reclassified the 2004 balance sheet amounts related to discontinued operations/assets held for sale. Consequently, on a comparable basis, under IFRS non-current financial liabilities would amount to 38,186 million, with an increase of 539 million under U.S. GAAP. Such increase mainly arose from:

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- the different accounting treatment of some aspects of real estate transactions entered into by the Telecom Italia Group, mainly in previous years. Under IFRS, such transactions have been recorded in accordance with the finance method, except for the land element which, in absence of a contractual purchase option or passage of title to Telecom Italia, was treated as operating lease. Such accounting treatment was also followed under U.S. GAAP except for the land element which, when less than 25% of the fair value of the property, was treated as finance lease with an additional increase in debt. The additional debt amounts to 543 million;
- the application of the purchase accounting method under U.S. GAAP to business combinations which occurred prior to 2004, which led to the valuation of liabilities at fair values and an increase of debt of 332 million;

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- the different accounting treatment of the convertible notes/bonds, which under IFRS are recognized by bifurcating the debt and the call option, with the latter being classified in a specific equity reserve. The additional debt under U.S. GAAP amounted to 416 million;
- the different accounting treatment of the securitization: under U.S. GAAP the sale of accounts receivable met the criteria for the derecognition of the assets sold while, under IFRS, the Qualified Special Purpose Entity of the securitization program was consolidated. Consequently, under U.S. GAAP the debt was lower by 728 million.

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Cautionary Statement For Purposes Of The Safe Harbor Provisions Of The United States Private Securities Litigation Reform Act Of 1995

5.9 CAUTIONARY STATEMENT FOR PURPOSES OF THE SAFE HARBOR PROVISIONS OF THE UNITED STATES PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

The foregoing discussion in Item 5. Operating and Financial Review and Prospects and the following discussion under Item 11. Quantitative and Qualitative Disclosures About Market Risks contain forward-looking statements which reflect management's current views with respect to certain future events, trends and financial performance. Actual results may differ materially from those projected or implied in the forward-looking statements. Further, certain forward-looking statements are based upon assumptions of future events and trends which may not prove to be accurate.

The following important factors could cause our actual results to differ materially from those projected or implied in any forward-looking statements:

- the continuing impact of increased competition in a liberalized market, including competition from global and regional alliances formed by other telecommunications operators in our core Italian domestic fixed-line and wireless markets;
- our ability to introduce new services to stimulate increased usage of our fixed and wireless networks to offset declines in the traditional fixed-line voice business due to the continuing impact of regulatory required price reductions, market share loss, pricing pressures generally and shifts in usage patterns;
- the level of demand for telecommunications services, particularly wireless telecommunications services in the maturing Italian market and for new higher value added products and services such as broadband;
- our ability to achieve the planned synergies expected to be generated by the merger of Telecom Italia and TIM including expenses, capital expenditures and capacity to launch new convergent services;
- the success of our customer loyalty and retention programs and the impact of such programs on our revenues;
- the impact of regulatory decisions and changes in the regulatory environment, including implementation of recently-adopted EU directives in Italy;
- our ability to successfully implement the new structure following the Telecom Italia and TIM merger;
- the impact of economic development generally on our international business and on our foreign investments and capital expenditures;
- the continuing impact of rapid or disruptive changes in technologies;
- the impact of political and economic developments in Italy and other countries in which we operate;

- the impact of fluctuations in currency exchange and interest rates;
- our ability to successfully implement our strategy over the 2006-2008 period;
- our ability to successfully achieve our debt reduction targets;
- our ability to successfully implement our Internet and broadband strategy both in Italy and abroad;
- our ability to achieve the expected return on the investments and capital expenditures we have made and continue to make in Brazil and in Europe on broadband;
- the amount and timing of any future impairment charges for our licenses, goodwill or other assets; and
- the impact of litigation or decreased mobile communications usage arising from actual or perceived health risks or other problems relating to mobile handsets or transmission masts.

The foregoing factors should not be construed as exhaustive. Due to such uncertainties and risks, readers are cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date hereof. We undertake no obligation to release publicly the result of any revisions to these forward-looking statements which may be made to reflect events or circumstances after the date hereof, including, without limitation, changes in our business or acquisition strategy or planned capital expenditures, or to reflect the occurrence of unanticipated events.

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Quantitative And Qualitative Disclosures About Market Risks

5.10 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

The following discussion should be read in conjunction with the Note 3 Accounting Policies , Note 5 Financial Risk Management , Note 23 Financial Instruments and Note 45 Additional U.S. GAAP Disclosures of the Notes to the Consolidated Financial Statements.

Derivative financial instruments are used by the Telecom Italia Group to manage its exposure to foreign exchange rate and interest rate risks and to diversify the parameters of debt so that costs and volatility can be reduced to within prefixed operational limits.

Derivative financial instruments at December 31, 2005 are principally used by the Group for the management of its debt positions. They include interest rate swaps (IRS) and interest rate options (IRO) to reduce interest rate exposure on fixed-rate and floating-rate bank loans and bonds and cross currency and interest rate swaps (CCIRS) and currency forwards to convert the loans secured in different foreign currencies to the functional currencies of the various companies of the Group.

IRSs and IROs involve or can involve, at specified maturity dates, the exchange of flows of interest calculated on the notional amount at the agreed fixed or floating rates, with the counterparts.

The same also applies to CCIRSs which, in addition to the settlement of periodic interest flows, can involve the exchange of principal, in the respective currencies of denomination, at maturity and eventually at another date.

Although a small number of derivatives have not been designated for hedge accounting treatment under FAS 133 and IAS 39, such derivatives are related to an underlying liability in all cases, therefore providing an economic hedge despite the accounting designation and treatment (please see 5.10.3 Financial Instruments). Consequently management believes that Telecom Italia s use of derivatives is not speculative.

5.10.1 DEBT POLICY

Telecom Italia Group s debt used to support the financing of its domestic and international businesses contains an element of market risk from changes in interest and currency rates. With respect to interest rates applicable to medium and long-term debt, Telecom Italia Group s policy is to utilize a defined ratio of floating rate and fixed rate debt with a different range of maturities. Telecom Italia Group s policy is intended to optimize the cost of funding/risk exposure mix, utilizing as providers of funds domestic and international capital markets and supranational agencies such as the European Investment Bank. Telecom Italia Group policies address the use of financial derivatives, including the approval of counterparties and the investment of excess liquidity. These policies are intended to minimize financial risks and obtain more favorable terms from the counterparts. In addition, Telecom Italia has a centralized treasury that provides assistance to its subsidiaries worldwide and usually operates as the Telecom Italia Group s

Table of Contents**Item 5. Operating And Financial Review And Prospects****Quantitative And Qualitative Disclosures About Market Risks**

The table below sets forth, for the periods indicated, the aggregate nominal amount of long-term debt outstanding at year-end (excluding current portion of long-term debt and leases payable/long rent) and the average interest rate, broken down into fixed and floating.

	Year ended December 31,						
	2006	2007	2008	2009	2010	2011	Thereafter
	(millions of Euro, except percentages)						
Long-Term Fixed Rate Debt	21,751	18,677	16,972	13,191	12,563	9,788	7,524
Average Fixed Rate	5.86%	5.83%	5.82%	5.77%	5.97%	5.82%	5.56%
Long-Term Floating Rate Debt Swapped into Fixed Rate Debt	3,245	3,245	3,245	3,135	135	135	135
Average Swapped into Fixed Rate	3.27%	3.27%	3.27%	3.27%	4.26%	4.26%	4.26%
Average Total Fixed Rate	5.52%	5.45%	5.41%	5.29%	5.95%	5.80%	5.54%
Total Fixed Rate Debt	24,996	21,922	20,217	16,326	12,698	9,923	7,659
Long-Term Floating Rate Debt	7,988	7,502	6,970	6,792	6,722	6,314	746
Average Floating Rate	3.24%	3.23%	2.96%	2.64%	2.59%	2.53%	2.81%
Long-Term Fixed Rate Debt Swapped into Floating Rate Debt	7,086	7,081	6,227	6,220	4,561	4,556	4,550
Average Swapped into Floating Rate	3.21%	3.20%	2.97%	2.96%	3.06%	3.05%	3.02%
Average Total Floating Rate	3.23%	3.22%	2.96%	2.79%	2.78%	2.75%	2.99%
Total Floating Rate Debt	15,074	14,583	13,197	13,012	11,283	10,870	5,296
Total Long-Term Debt	40,070	36,505	33,414	29,338	23,981	20,793	12,955

As of December 31, 2005, approximately 78% of Telecom Italia Group's long-term debt was denominated in Euro, while the remaining, 11,653 million, was denominated in foreign currencies primarily U.S. Dollars, Pound Sterling, Brazilian Reals and Japanese Yen. After taking into account the Company's derivative financial instruments, the Company's long-term debt is not materially exposed to fluctuations in foreign exchange rates. At December 31, 2005, approximately 34% of the long-term debt (including current portion) carried a floating rate.

5.10.2 MARKET RISK POLICY

Telecom Italia Group's policies regarding market risk consist of the following:

- the Finance Department advises the maximum level of interest rate risk to which the Telecom Italia Group should be exposed to an internal committee which meets on a regular basis in order to monitor the activities and the level and value of the current market risk exposures. The Centralized Treasury, operating as a service center, within the Finance Department supplies financial services and actively supports our subsidiaries according to their requirements and local circumstances;
- we use derivative financial instruments to manage these financial market risks, and have established policies to handle and mitigate the adverse effects of these exposures; and
- we continually evaluate the credit quality of counterparties to minimize the risk of non-performance. The counterparties to derivative contracts are generally highly rated banks and financial institutions and such counterparties are continually monitored in order to minimize the risk of non-performance.

5.10.3 FINANCIAL INSTRUMENTS

V INTEREST RATE AND FOREIGN EXCHANGE RISK MANAGEMENT

We have established a set of guidelines in order to manage financial risks. In particular, an internal committee monitors exposure to market risks (both interest rate and foreign exchange risk) the use of financial derivatives for the management of those risks and credit risks. Counterparties in derivatives are banks and financial institutions having generally a rating of at least A- or better, which is constantly monitored in order to minimize credit risk.

We seek to diversify and minimize interest rate exposure of our operating and financing activities through portfolio diversification and, according to the evaluation of our exposures, selectively enter into derivatives

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instruments. Since our corporate objective is pursued through our commercial operations, i.e., the sale of telecommunications and media services, foreign exchange exposures are normally hedged, provided the risks would affect our cash flows.

We are exposed to market risks arising from changes in interest rates, primarily in the Euro zone, in the United States, in Great Britain and in Latin America. We define the optimal mixture of fixed and floating-rate debt at the consolidated level and enter into financial derivatives to adjust the risk profile to the defined target mixture. IRS and IRO are therefore used to reduce the interest rate exposure on fixed-rate and floating-rate notes, bonds and bank loans. Taking into account our operations in various sectors, in terms of risk, volatility and the amount of anticipated operations cash flows, the optimum blend of medium/long term non current financial liabilities has been established at 70% fixed rate and 30% floating rate. We use CCIRS and foreign currency forwards to convert foreign currency loans and bonds mainly in U.S. Dollars and Pound Sterling into the functional currencies of the various subsidiaries. As a result of these hedge activities, as of December 31, 2005, we were not subject to any material foreign exchange risk in our financial debt.

To determine the market value of the financial derivatives, we use various pricing models. The market value of interest rate swaps and of cross currency and interest rate swaps reflects the difference between the fixed rate to be paid/received and the interest rate (having the same expiration date as the swap) assessed on the basis of the market environment on the evaluation date. With regard to IRSs the principal amount is not exchanged between the parties and therefore does not constitute a measure of exposure to credit risk, which is instead limited to the amount of interest or interest differentials to be received at the interest date.

The market value of cross currency and interest rate swaps depends also on the difference between the reference foreign exchange rate on the agreement date and the foreign exchange rate on the valuation date, because generally CCIRS involve the exchange of capital in the respective currencies of denomination at maturity and eventually at another date, in addition to the settlement of periodic interest flows.

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As of December 31, 2005 the total notional amount of our derivative instruments amounted to 17,616 million, of which 17,002 million related to derivative instruments on debt positions and 614 million related to derivative instruments on financial assets and on short-term treasury operations, as detailed in the following table:

Type of derivative	Hedged Risk	Notional amount	Mark to Market Spot (Clean Price) as of December 31, 2005
(millions of Euro)			
Interest Rate Swaps	Interest Rate Risk		
Cross Currency and Interest Rate Swaps	Interest Rate Risk and Foreign Currency Exchange Rate Risk	7,359	(62)
Fair Value Hedge Derivatives		7,359	(62)
Interest Rate Swaps	Interest Rate Risk	4,275	13
Cross Currency and Interest Rate Swaps	Interest Rate Risk and Foreign Currency Exchange Rate Risk	3,483	(405)
Cash Flow Hedge Derivatives		7,758	(392)
Interest Rate Swaps and Interest Rate Options	Interest Rate Risk	1,865	(7)
Cross Currency and Interest Rate Swaps	Interest Rate Risk and Foreign Currency Exchange Rate Risk	20	(1)
Non-Hedge Accounting Derivatives		1,885	(8)
Total Derivative Instruments on Debt Positions		17,002	(462)
Interest Rate Swaps on Assets	Interest Rate Risk	125	(5)
Cross Currency and Interest Rate Swaps on Assets	Interest Rate Risk and Foreign Currency Exchange Rate Risk	61	(2)
Currency Forwards	Foreign Currency Exchange Rate Risk	428	(4)
Derivative Instruments on Financial Assets and on Short-term Treasury Operations (Non-Hedge Accounting Treatment)		614	(11)
Total Telecom Italia Group Derivatives		17,616	(473)

- **DERIVATIVE INSTRUMENTS ON DEBT POSITIONS**

The following tables give a description of our financial derivative contracts outstanding as of December 31, 2005 to manage the debt positions. The notional amount is net of compounded derivatives. Whenever a derivative is set up on another derivative, the notional amount is reported once and the net effect of the two compounded derivatives is considered.

	Notional amount at 12/31/2005	Market value of derivatives at 12/31/2005 (a)	Market value of underlying debt positions at 12/31/2005 (b)	Market value of debt including related derivatives at 12/31/2005 (c)=(b-a)	Market value of derivatives at 12/31/2004
(millions of Euro)					
Interest rate swaps and interest rate options	6,140	6	6,302	6,296	45
Cross-currency and interest rate swaps	10,862	(468)	10,851	11,319	(1,305)
Total	17,002	(*) (462)	17,153	17,615	(*) (1,260)

(*) Most of the market value of derivatives is attributable to the currency exchange variations which are offset by the currency exchange variations on the underlying position.

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As of December 31, 2005, derivative instruments on debt positions, are classified as follows by maturity:

	2006	2007	2008	2009	2010	Thereafter	Total	Market value of underlying debt position at 12/31/2005
	(millions of Euro)							
Derivatives on Debt Positions	1,163	1,461	863	1,471	4,602	7,442	17,002	17,153

The following tables set forth a description of our financial derivative contracts outstanding as of December 31, 2005 used to hedge debt positions.

INTEREST RATE SWAPS AND INTEREST RATE OPTIONS

At December 31, 2005, Telecom Italia Group companies had IRS and IRO contracts relating to financial liabilities recorded in the financial statements, for total principal equal to the notional amount of 6,140 million. Details of such contracts are set forth in the table below.

	Maturities							
Interest Rate Derivatives	2006	2007	2008	2009	2010	Thereafter	Total	Mark to Market
	(millions of Euro)							
EUR Interest Rate Swaps								
Receive variable, pay fixed								
Amount	1,100			110	3,000	120	4,330	
Average pay rate	2.89%			3.35%	3.09%	4.16%		
Average receive rate	3M Euribor + 23 bps			3M Euribor + 60 bps	6M Euribor	3M Euribor + 66 bps		
Amount				500			500	
Average pay rate				4.06%				
Average receive rate				6M Euribor + 142 bps (1)				
Sub-total	1,100			610	3,000	120	4,830	7
EUR Interest Rate Swaps								
Receive variable, pay variable								
Amount	41			500			541	(6)
Average pay rate								

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	6M Euribor 3 bps				6M Euribor arr. +190 bps (3)			
<i>Average receive rate</i>	Rendiob, Bot, Rendistato (2)				6M Euribor + 244 bps (4)			
Quanto swaps								
<i>Amount</i>				350 (5)	350	3M Stibor	700	5
<i>Average pay rate</i>					3.36%	(6)		
<i>Average receive rate</i>					7.00%			
BRL Interest Rate Swaps								
Receive fixed, pay variable								
<i>Amount</i>	10	14	13	11	9	12	69	
<i>Average pay rate</i>	CDI (7)	CDI (7)	CDI (7)	CDI (7)	CDI (7)	CDI (7)		
<i>Average receive rate</i>	11.3%	11.3%	11.3%	11.3%	11.3%	11.3%		
Total	1,151	14	13	1,471	3,009	482	6,140	6

(1) From February, 2007 onward: 6 months Euribor + 142 bps for each week in which 5 year EUR CMS > 1 year EUR CMS.

(2) Rolint, Robot, Rendint and Rendiob are customary domestic Italian parameters for medium/long term debt.

(3) Purchase of a cap at 4.50%; sale of a cap at 5.50%.

(4) From July, 2007 onward: 6 months Euribor + 244 bps for each week in which 5 year EUR CMS > 1 year EUR CMS.

(5) Sale of a floor on 6 months USD Libor arrears. At decreasing rates from 3.80% to 3.15%.

(6) Purchase of a cap at 3.65%; sale of a floor at a rising rate from 1.75% to 3.20%.

(7) The CDI is the customary domestic Brazilian measure of overnight interest rate. As of December 31, 2005 this rate was around 17.99%.

Table of Contents**Item 5. Operating And Financial Review And Prospects****Quantitative And Qualitative Disclosures About Market Risks***Cross-Currency And Interest Rate Swaps And Currency Forwards*

At December 31, 2005, Telecom Italia Group companies had CCIRS contracts relating to financial liabilities recorded in the financial statements, for total principal equal to a notional amount of 10,862 million. Details of such contracts are set forth in the table below. References to JPY are to Japanese Yen and BRL to Brazilian Reais.

Maturities

Foreign Exchange Derivatives	2006	2007	2008	2009	2010	Thereafter	Total	Mark to Market
(millions of Euro)								
CCIRS								
Receive fixed USD, pay variable Euro								
<i>Amount</i>			850		1,014	1,817		
			3M Euribor		6M Euribor	6M Euribor	3,681	
<i>Average pay rate</i>			+ 53 bps		+ 41 bps	+ 82 bps		
<i>Average receive rate</i>			4.0%		4.0%	5.4%		
<i>Amount</i>					579	1,157		
					6M Euribor	6M Euribor	1,736	
<i>Average pay rate</i>					+ 55 bps	+ 75 bps		
<i>Average receive rate</i>					4.875%	5.25%		
Sub-total			850		1,593	2,974	5,417	25
CCIRS								
Receive fixed USD, pay fixed Euro								
<i>Amount</i>						2,558	2,558	(328)
<i>Average pay rate</i>						5.4%		
<i>Average receive rate</i>						5.6%		
CCIRS								
Receive dual currency (fixed USD rate, JPY principal at maturity), pay fixed Euro								
<i>Amount</i>						174	174	(70)
<i>Average pay rate</i>						6.94%		
<i>Average receive rate</i>						5.0%		
CCIRS								
Receive fixed Yen, pay variable Euro								
<i>Amount</i>						171	171	(65)
<i>Average pay rate</i>						6M Euribor + 274 bps		
<i>Average receive rate</i>						3.55%		
CCIRS								
Receive variable USD, pay variable Euro								
<i>Amount</i>		150				332	482	9
<i>Average pay rate</i>		3M Euribor -4 bps				6M Euribor + 56 bps		
<i>Average receive rate</i>		3M USD Libor				3M USD Libor		

-7 bps

+ 48 bps

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Foreign Exchange Derivatives	Maturities							Mark to Market
	2006	2007	2008	2009	2010	Thereafter	Total	
(millions of Euro)								
CCIRS								
Receive fixed GBP, pay variable Euro								
<i>Amount</i>		685					685	
<i>Average pay rate</i>		6M Euribor +67 bps						
<i>Average receive rate</i>		6.375%						
<i>Amount</i>		604					604	
<i>Average pay rate</i>		3M Euribor +73 bps						
<i>Average receive rate</i>		6.375%						
Sub-total		1,289					1,289	(31)
CCIRS								
Receive fixed GBP, pay fixed Euro								
<i>Amount</i>						751	751	(7)
<i>Average pay rate</i>						4.34%		
<i>Average receive rate</i>						5.625%		
CCIRS								
Receive fixed USD, pay variable BRL								
<i>Amount</i>	12	8					20	(1)
<i>Average pay rate</i>	CDI (1)	CDI (1)						
<i>Average receive rate</i>	Exchange rate variation + spread	Exchange rate variation + spread						
Total	12	1,447	850		1,593	6,960	10,862	(468)

(1) The CDI is the customary domestic Brazilian measure of overnight interest rate. As of December 31, 2005 this rate was around 17.99%.

- DERIVATIVE INSTRUMENTS ON FINANCIAL ASSETS AND ON SHORT-TERM TREASURY OPERATIONS**

The Telecom Italia Group also entered into derivative contracts to manage the interest rate and foreign currency risk on its financial assets (bonds, bonds bought back and intercompany loans) and on short-term treasury operations for a nominal amount of approximately 614 million.

Description	Equivalent notional amount
-------------	----------------------------------

	(millions of Euro)
Currency Forward transactions (Telecom Italia Finance S.A.)	350
Currency Forward transactions (Telecom Italia S.p.A.)	40
Currency Forward transactions (Tim Italia S.p.A.)	10
Currency Forward transactions (Telecom Italia Capital S.A.)	1
Currency Forward transactions (Telecom Italia Sparkle S.p.A.)	15
Currency Forward transactions (Olivetti S.p.A.)	12
Asset Swap (Telecom Italia Finance S.A.)	186
Total	614

The market value of derivatives on financial assets and short-term treasury operations as of December 31, 2005 was a net loss of approximately 11 million compared to a net gain of 13 million as of December 31, 2004. The market value of short-term treasury operations has been measured by discounting at December 31, 2005, for each transaction, the product between (i) the amount purchased/sold and (ii) the difference between the contractual exchange rate and the forward exchange rate as of December 31, 2005 having the same maturity date.

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The Board of Directors of Telecom Italia S.p.A. was appointed at the Telecom Italia shareholders meeting held on May 6, 2004 for a three-year term, which will expire at the annual shareholders meeting to be called to approve the Company's financial statements for the year ended December 31, 2006. The shareholders meeting of April 7, 2005 resolved to enlarge the Board of Directors by increasing the number of Directors from nineteen to twenty-one and appointed, as additional Directors, Marco de Benedetti and Enzo Grilli. Subsequently, as a result of Marco De Bendetti and Giovanni Consorte resigning as Directors on October 5, 2005 and January 23, 2006 respectively, the shareholders meeting of April 13, 2006 appointed Diana Bracco and Vittorio Merloni as replacements. The new Directors were elected to serve concurrently with the other Directors, until the shareholders meeting that will be called to approve the financial statements for the year ended December 31, 2006.

The following are the members of the Board of Directors of Telecom Italia as of May 10, 2006.

<u>Name</u>	<u>Age</u>	<u>Position</u>	<u>Appointed</u>
Marco Tronchetti Provera	58	Chairman(1)	2004
Gilberto Benetton	64	Deputy Chairman(1)	2004
Carlo Orazio Buora	60	Managing Director General Manager(2)	2004
Riccardo Ruggiero	45	Director	2004
Paolo Baratta(3)	66	Director	2004
John Robert Sotheby Boas(3)	69	Director	2004
Diana Bracco(3)	64	Director	2006
Domenico De Sole(3)	62	Director	2004
Francesco Denozza(3)	59	Director	2004
Luigi Fausti(3)	77	Director	2004
Guido Ferrarini(3)	55	Director	2004
Jean Paul Fitoussi(3)	63	Director	2004
Enzo Grilli(3)	62	Director	2005
Vittorio Merloni(3)	73	Director	2006
Gianni Mion	62	Director	2004
Massimo Moratti	61	Director	2004
Marco Onado(3)	65	Director	2004
Renato Pagliaro	49	Director	2004
Pasquale Pistorio(3)	70	Director	2004
Carlo Alessandro Puri Negri	53	Director	2004
Luigi Roth(3)	65	Director	2004

(1) Appointed by the Board of Directors on May 6, 2004.

(2) Appointed as General Manager by the Board of Directors on August 4, 2003 (reference is made to Telecom Italia post Merger). Appointed as Managing Director by the Board of Directors on May 6, 2004.

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(3) Independent Director. For details on the criteria applied to determine independence, see Item 10. Additional Information 10.1 Corporate Governance 10.1.2 General Board of Directors Independent Directors .

In 2005 the Board met eleven times, with such meetings generally scheduled pursuant to a timetable set forth in advance.

As of May 10, 2006, the Secretary of the Board of Directors was the General Counsel of Telecom Italia, Francesco Umile Chiappetta.

According to article 13 of the Bylaws and Articles 10 and 12 of the Company's Self-Regulatory Code, the Board set up two committees from among its members: the Internal Control and Corporate Governance Committee and the Remuneration Committee. Both committees are charged with giving advice and making proposals to the Board of Directors. On September 9, 2004, the Board also established a Strategy Committee, to increase the involvement of the Directors as a group in the Telecom Italia Group's strategic decision-making.

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Directors

The members of the Internal Control and Corporate Governance Committee are Guido Ferrarini (Chairman), Francesco Denozza, Domenico De Sole and Marco Onado; the Committee held eleven meetings in 2005. The Committee meetings are normally attended by the Chairman of the Board of Auditors or by another auditor it designates; where deemed desirable in light of the issues on the agenda, the Committee and the Board of Auditors have held joint meetings.

The members of the Remuneration Committee are Luigi Fausti, Pasquale Pistorio and Paolo Baratta; the Committee met three times in 2005.

The Strategy Committee consists of the Chairman of the Board (Marco Tronchetti Provera), the Managing Director charged with Group-wide corporate functions (Carlo Orazio Buora) and the non-executive Directors Domenico De Sole, Marco Onado and Pasquale Pistorio. The Strategy Committee met four times in 2005.

On September 9, 2004, the Board of Directors appointed as Lead Independent Director the Chairman of the Internal Control and Corporate Governance Committee (Mr. Guido Ferrarini).

For a detailed description of Telecom Italia's corporate governance, including activities, responsibilities and organization of the Board of Directors and the Committees, see Item 10. Additional Information 10.1 Corporate Governance .

6.1.1 BIOGRAPHICAL DATA

The following are the selected biographical data of the Directors.

Marco Tronchetti Provera: Marco Tronchetti Provera was born in Milan, in 1948. Mr. Tronchetti Provera has been Telecom Italia's Chairman since September 27, 2001. Mr. Tronchetti Provera began his career in 1973 working in the family maritime transport business and establishing a financial holding company. In 1986 he joined the Pirelli Group, a world leader in the production of tyres, energy and telecommunications infrastructure and in 1992 took over responsibility for operations. Mr. Tronchetti Provera is also Chairman of Pirelli & C. S.p.A., of Pirelli & C. Real Estate S.p.A., of Olimpia S.p.A., of Camfin S.p.A., of Marco Tronchetti Provera & C. S.a.p.a. and GPI Gruppo Partecipazioni Industriali S.p.A., Deputy Chairman of Confindustria, a Director of Luigi Bocconi University, Chairman of the Council for Relations between Italy and the United States, of the Silvio Tronchetti Provera Foundation, member of the Italian Group of the Trilateral Commission, of the International Advisory Board of Allianz, of the International Council of J.P. Morgan, of the New York Stock Exchange European Advisory Committee and of the Assonime Steering Committee.

Gilberto Benetton: Gilberto Benetton was born in Treviso, in 1941. Mr. Benetton has been Telecom Italia Deputy Chairman since September 27, 2001. He began his activity in 1965 with his brothers Giuliana, Luciano and Carlo. The Benetton Group is now active in 120 countries. Mr. Benetton is also Deputy Chairman of Olimpia S.p.A, Chairman of Edizione Holding S.p.A., Autogrill S.p.A., Ragione S.a.p.a., Verde Sport S.p.A., Deputy Chairman of Fondazione Benetton, Director of Benetton Group S.p.A.,

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Pirelli & C. S.p.A., Mediobanca S.p.A., Schemaventotto S.p.A., Lloyd Adriatico S.p.A., Autostrade S.p.A. and Aldeasa S.A..

Carlo Orazio Buora: Carlo Orazio Buora was born in Milan, in 1946. Mr. Buora has been Managing Director of Telecom Italia since November 7, 2001. He is also Managing Director of Pirelli & C. S.p.A.. He began working in finance with the BNL Group. Afterwards he became head of Finance and Administration at Merloni Finanziaria and Chief Financial Officer at Snia Viscosa. In 1984 he joined the Fiat Group. In 1989 he was appointed Deputy General Manager of Telettra and subsequently General Manager of the Benetton Group, a position he held until 1991. In November 1991 he joined the Pirelli Group as central manager for finance and administration and was appointed General Manager in 1992. In 1999 he became a general partner of Pirelli & C. S.p.A. and in 2001 was appointed Managing Director of Pirelli & C. S.p.A. Mr. Buora is also a Director of Pirelli & C. Real Estate S.p.A., of Olimpia S.p.A., of RCS Mediagroup S.p.A., of Ras S.p.A., and of Mediobanca S.p.A. Mr. Buora has been Deputy Chairman of F.C. Internazionale S.p.A..

Riccardo Ruggiero: Riccardo Ruggiero was born in Naples, in 1960. Since October 1, 2001 Mr. Ruggiero has been Head of the Telecom Italia Group Wireline Business Unit. On May 7, 2002 he was appointed General Manager of Telecom Italia and on September 5, 2002 he was appointed Managing Director. He began his career in

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1986 as sales manager of Fininvest S.p.A.. Between 1988 and 1990 he was sales and marketing manager of the Italian branch of AT&T. In 1990 he joined the Olivetti Group, where he held various positions: in 1992 he was appointed Vice President of Organizzazione Oliservice, with responsibility for international clients and the commercial development of telecommunications services worldwide, and in 1994 of Olivetti Telemidia, with responsibility for commercial development and market expansion. In 1996 he was appointed Managing Director of Infostrada S.p.A. (with responsibility for the market, infrastructure and personnel functions) and was later appointed Managing Director of Italia On Line. In July 2001, Mr. Ruggiero joined the Telecom Italia Group as Head of the Telecom France Business Unit, responsible for managing and developing Telecom Italia Group's business on the French market. Mr. Ruggiero has been Director of Safilo Group S.p.A. since October 24, 2005.

Paolo Baratta: Paolo Baratta was born in Milan in 1939. Mr. Baratta has been a Director of Telecom Italia since May 6, 2004. In 1967 he began doing economic research at the Associazione per lo sviluppo dell'industria nel Mezzogiorno (Svimez) in Rome. In 1979 he became a Director of the Istituto per il Credito alle Imprese di Pubblica Utilità (ICIPU) and then Deputy Chairman. From 1980 to 1992 he was Chairman of ICIPU, Consorzio di Credito per le Opere Pubbliche (CREDIOP), Deputy Chairman of Nuovo Banco Ambrosiano (later Banco Ambrosiano Veneto) and the Italian Bankers' Association (ABI). In addition to being a Director of various companies, he was Chairman of the Centro Beneduce per gli Studi in Campo Bancario e Assicurativo. In 1993 he became Minister for Privatizations with responsibility for the reorganization of the system of state holdings. In 1993-94 he was Minister for Foreign Trade and Minister for Industry ad interim. In 1995-96 he was Minister for Public Works and Minister for the Environment. From 1997 to 2000 he was chairman of Bankers' Trust S.p.A. and from 1998 to 2000 Chairman of the Biennale di Venezia. He is a member of the Società Italiana degli Economisti and currently is Chairman of the Comitato Venezia Internazionale, the Centro per la Proprietà Intellettuale di Venezia and the Fondazione Lorenzo Valla. He is also a Director of Banca Finnat Euroamerica, Edizione Holding S.p.A., Svimez-Roma, the Fondo per l'Ambiente Italiano (FAI).

John Robert Sotheby Boas: John Robert Sotheby Boas was born in London in 1937. Mr. Boas has been a Director of Telecom Italia since May 6, 2004. He joined Price Waterhouse & Co. in 1964 as a chartered accountant. From 1965-66 he worked for ICI in the Overseas Treasurer's Department and in 1966 he moved to SGWarburg & Co., where he worked on mergers and acquisitions, IPOs and bond issues. He was appointed Director in 1971 and Deputy Chairman in 1990. During the 1990s he worked on developing the company's business in continental Europe, with specific responsibility for Italy. Following the acquisition of SGWarburg by Swiss Bank Corporation, he was Managing Director of SBC Warburg until his retirement in 1997. He continued to act as a consultant for UBS Warburg until April 30, 2004.

Diana Bracco: Diana Bracco was born in Milan, in 1941. Mrs. Bracco has been a Director of Telecom Italia since April 13, 2006. Graduated with a Degree in Chemistry from the University of Pavia where, in 2001, she was awarded an Honorary Degree in Pharmaceutical Science. Mrs. Bracco is currently Chairman and Managing Director of Bracco S.p.A.; Managing Director of Centro Diagnostico Italiano S.p.A.; Director of Humanitas S.p.A., CNR (National Research Council) and Assonime (Association for Italy's Limited Liability Companies). She is also President of Assolombarda (Association of Firms in the Province of Milan), member of the General Council of Confindustria (Confederation of Italian Industry), member of the President's Committee and past President of Federchimica (Italian Federation of the Chemical Industry), President of Confarma and Confindustria's Mai Foundation for Research.

She was awarded the honorific title of Cavaliere del Lavoro in 2002; has an honorary degree in Medicine from the Università Cattolica del Sacro Cuore in Rome.

Domenico De Sole: Domenico De Sole was born in Rome in 1944. Mr. De Sole has been a Director of Telecom Italia since May 6, 2004. In 1970 he moved to the United States, where he became a partner with the law firm of Patton, Boggs & Blow. In

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1984 he joined the Gucci Group as Managing Director of Gucci America Inc. and in 1995 he became Managing Director for the entire Gucci Group as President and Managing Director of Gucci Group NV until April 2004. During this period Gucci Group was listed on the New York and Amsterdam stock exchanges (1995), beat off a hostile takeover bid (1999), acquired Yves Saint Laurent, Sanofi Beauté and Sergio Rossi in 1999, Boucheron, Alexander McQueen and Bedat & Co in 2000 and Bottega Veneta, Stella McCartney and Balenciaga in 2001. Mr. De Sole is a Director of Delta Airlines (member of Finance and Governance Committees), of Bausch & Lomb (member of the Audit Committee) and Gap. Inc. (member of the Compensation Committee). He is a member of the Advisory Board of the Harvard Law School.

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Francesco Denozza: Francesco Denozza was born in Turin in 1946. Mr. Denozza has been a Director of Telecom Italia since November 7, 2001. He is currently Chairman of the Board of Statutory Auditors of Siemens S.p.A. and Siemens Holding S.p.A.. Mr. Denozza is also Professor of Commercial Law at the University of Milan, lawyer and Co-editor of the legal review *Giurisprudenza Commerciale*. Mr. Denozza is the author of several publications.

Luigi Fausti: Luigi Fausti was born in Ancona, in 1929. Mr. Fausti has been a Director of Telecom Italia since November 7, 2001. He is also Director of Monrif S.p.A., of Poligrafici Editoriale S.p.A. di Bologna, of Mediaset S.p.A. and Chairman of Patrimonio Immobiliare dello Stato S.p.A.. Mr. Fausti began his career in 1947 in Banca Commerciale Italiana where he was Executive Officer and General Director of several branches and subsequently became Managing Director of the bank in 1990, Vice-Chairman and Managing Director in 1994, Chairman in 1997 and Honorary Chairman in 1999. He received an *honoris causa* economics degree from Naples University.

Guido Ferrarini: Guido Ferrarini was born in Genoa in 1950. Mr. Ferrarini has been a Director of Telecom Italia since June 12, 2001 and Lead Independent Director since September, 2004. Mr. Ferrarini obtained an LL.M. from Yale Law School in 1978. He is professor of law at the University of Genoa and Director of the Center of Law and Finance; he is also Chairman of TLX S.p.A. (a new Italian investment exchange) and Deputy Chairman of the European Corporate Governance Institute (ECGI), Brussels. From 2000 to 2004 he was member of the Board of Trustees of the International Accounting Standards Committee (IASC), London. Mr. Ferrarini is an independent Director of Autostrade S.p.A. and of Assogestioni (the Italian Asset Managers Association). He is the author of several publications and articles in the fields of financial, corporate and business law. He was a Visiting Professor at the Colombia Law School, Hamburg University, New York University Law School and University College of London. Mr. Ferrarini is co-editor of the *Rivista delle Società* (Giuffrè) and editor of ECGI Law Working Papers.

Jean Paul Fitoussi: Jean-Paul Fitoussi was born in La Goulette (Tunisia) in 1942. Mr. Fitoussi has been a Director of Telecom Italia since May 6, 2004. Mr. Fitoussi is Professor of Economics at the Institut d'Études Politiques in Paris, where has taught since 1982 and whose Scientific Committee he now chairs. He is currently President of the Observatoire Français des Conjonctures Economiques (OFCE), an economic research and forecasting institute. Mr. Fitoussi graduated cum laude in Law and Economics from the University of Strasbourg with a thesis on inflation, equilibrium and unemployment. He began his academic career as an assistant professor at the University of Strasbourg. Between 1979 and 1983 he taught at the European University Institute, Florence, and in 1984 was visiting professor at the University of California, Los Angeles. Since 1998 he has been a member of the board of the École Normale Supérieure. In 1997 he became a member of the Prime Minister's Council for Economic Analysis. In 1996 he was named to the Commission Économique de la Nation. He was secretary of the International Economic Association beginning in 1984 and has been an expert for the Economic and Monetary Committee of the European Parliament. Between 1990 and 1993 he was Chairman of the Economic Council of the European Bank for Reconstruction and Development. In the field of publishing, Mr. Fitoussi is managing editor of the *Revue et Lettre de L'OFCE* and serves on the scientific committee of the *Revue Française d'Économie*, the editorial board of *Labour* and of *The International Journal of Development Planning Literature*, and the scientific committee of *International Labour Review* and *Critique Internationale*. His writing appears regularly in newspapers in France and abroad and he is commentator for *La Repubblica* and *Le Monde*. Since 2002 he has been Director of the *Fondation Nationale des Sciences Politiques*. In the field of research, Mr. Fitoussi has concentrated on inflation theory, unemployment, foreign trade and the role of macroeconomic policy. As president of the OFCE and founder of its International Economic Policy Group (of which he is a member), he has made numerous contributions to the current economic policy debate, particularly on the issues of economic integration and transition.

Enzo Grilli: Enzo Grilli was born in Casarza Ligure (Genoa), in 1943. Mr. Grilli has been Director of Telecom Italia since April 7, 2005. He is also Professor of International Economics at the School of Advanced International Studies of the Johns Hopkins University in Washington D.C.. From 1993 to 1996, he was Executive Director of the World Bank, where he previously worked as Head Economist and Director of Development Policies. From 1997 to 1999, he was Executive Director of the International

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Monetary Fund. He has been member of the Board of Directors of TIM S.p.A. since 2001. Currently, he is also Director of Generali S.p.A.

Vittorio Merloni: Vittorio Merloni was born in Fabriano (Ancona), in 1933. Mr. Merloni has been a Director of Telecom Italia since April 13, 2006. Graduated with a degree in Economics and Commerce, since 1960 he has worked in the family business: he is currently Chairman of the Board Of Directors of Indesit Company S.p.A.

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(formerly Merloni Elettrodomestici S.p.A.) and its parent company Fineldo S.p.A.. He is also member of the General Council and Executive Committee of Confindustria (Confederation of Italian Industry) and Assonime (Association for Italy's Limited Liability Companies); a past President of both organizations, and member of Censis (Centre for Social Studies and Policies), the Council for Relations between Italy and the United States and Borsa Italiana's Corporate Governance Committee. He was awarded the honorific title of Cavaliere del Lavoro in 1984 and an honorary degree in Engineering from the Milan Polytechnic in 2001.

Gianni Mion: Gianni Mion was born in Vó (Padova), in 1943. Mr. Mion has been a Director of Telecom Italia since November 7, 2001. He is currently Managing Director of Edizione Holding S.p.A.; Director of Benetton Group S.p.A., Autogrill S.p.A., 21-Investimenti, Autostrade S.p.A., Cartiere Burgo S.p.A., Luxottica Group S.p.A., Olimpia S.p.A., Schemaventotto S.p.A.. Mr. Mion is also a Registered Auditor.

Massimo Moratti: Massimo Moratti was born in Boscohiesanuova (Verona), in 1945. Mr. Moratti has been a Director of Telecom Italia since November 7, 2001. He is also Director of Angelo Moratti di Gianmarco e Massimo Moratti & C. S.a.p.a., Managing Director of Saras S.p.A. Raffinerie Sarde, Chairman of Sarint S.A., Director of Interbanca S.p.A. and of Pirelli & C. S.p.A..

Marco Onado: Marco Onado was born in Milan in 1941. Mr. Onado has been a Director of Telecom Italia since May 6, 2004. He was a professor at the University of Modena from 1972 to 1984, then at the University of Bologna until 2001. Currently he teaches at Luigi Bocconi University. He has been a Visiting Professor at the University College of North Wales and Brown University in Providence, Rhode Island. From 1993 to 1998 he was a CONSOB Commissioner and in this capacity he was a member of the Draghi Committee for the reform of company law and of the Euro Committee. He also participated in the work of the International Organization of Securities Commissions (IOSCO). He was also a consultant to the Preda Committee, which drafted the Code of Conduct for listed companies in 2000 and the updated version in 2002. He is a member of the Società Italiana degli Economisti and of the Scientific Committee of the Prometeia Associazione per le Previsioni Econometriche. He also sits on the editorial board of several specialized reviews and is a columnist for the financial newspaper *Il Sole 24 Ore*. During his career he has been a director of various financial institutions. He has been Chairman of Pioneer Global Asset Management S.p.A. (Unicredit Group) since December, 2004 and Director of Prometeia S.r.l..

Renato Pagliaro: Renato Pagliaro was born in Milan in 1957. Mr. Pagliaro has been a Director of Telecom Italia since May 6, 2004. A registered auditor, he joined Mediobanca Banca di Credito Finanziario S.p.A. in 1981, where he has held positions of increasing responsibility. In April 2003 he was appointed Co-General Manager and Secretary to the Board of Directors of Mediobanca S.p.A.. Mr. Pagliaro is a Director and member of the Executive Committee of RCS Mediagroup S.p.A., Compass S.p.A. and Cartiere Burgo S.p.A.. He is also a Director of Ferrari S.p.A., SelmaBipiemme Leasing S.p.A. and Cofactor S.p.A.. Since 1993 he has been a member of the Board of Auditors of Istituto Europeo di Oncologia S.r.l..

Pasquale Pistorio: Pasquale Pistorio was born in Agira (Enna), in 1936. Mr. Pistorio has been a Director of Telecom Italia since May 6, 2004. Pasquale Pistorio spent the first 17 years of his career at Motorola before taking the helm of Italy's SGS Microelettronica in 1980. In May 1987, SGS and France's Thomson Semiconducteurs merged to create SGS-THOMSON Microelectronics, now ST Microelectronics N.V.. Under Pasquale Pistorio's guidance, ST Microelectronics established itself as a broad range manufacturer and rose through the world semiconductor ranks from number 15 in 1987 to one of the top five companies in the industry.

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In the last 25 years, Pasquale Pistorio has championed the cause of Europe's microelectronics industry and has been on the Board of MEDEA+ and Chairman of the European Union's Technology Platform (ENIAC). He has also been a firm advocate of corporate social responsibility, especially in the environmental field, for ethical and social reasons, as well as his conviction that environmentally friendly companies are more competitive. He has been a member of the United Nations Task Force dedicated to bridging the Digital Divide.

Since May 2004 Pasquale Pistorio was called to take the position of Deputy Chairman for Research and Innovation of Confindustria, the Confederation of Italian Industrialists and in this role he is a staunch advocate of research as a top priority for the political agenda of the country. In November 2005, Pistorio was also appointed Deputy Chairman for European Affairs of Confindustria. He is also a Director of the Boards of Fiat Group and Chartered Semiconductors (Singapore).

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Item 6. Directors, Senior Management and Employees

Directors

Throughout his career Pasquale Pistorio has received numerous awards and honors for his achievements. Upon his retirement as President and CEO of STMicroelectronics N.V. on March 18, 2005, Pistorio was appointed Honorary Chairman of the Company.

Carlo Alessandro Puri Negri: Carlo Alessandro Puri Negri was born in Genoa, in 1952. Mr. Puri Negri has been a Director of Telecom Italia since November 7, 2001. Mr. Puri Negri is also Director of Aon Italia S.p.A. and Olimpia S.p.A.. He is Deputy Chairman and Managing Director of Pirelli & C. Real Estate S.p.A., Deputy Chairman of Camfin S.p.A. and Pirelli & C. S.p.A.. He is Deputy Chairman and Managing Director of Pirelli & C. Ambiente S.p.A.. Since 2003 Mr. Puri Negri has been a Director of Istituto Europeo di Oncologia S.r.l. and a member of Real Estate Int. Advisory Board of Harvard University. He is also Director and Executive Committee member of Capitalia S.p.A.. Since 2004 Mr. Puri Negri is also Director of Fondazione Cerba and Assoimmobiliare (real estate industrial association in Italy) and member of the Residential Conditions Commission appointed by the Ministry of Public Infrastructures.

Luigi Roth: Luigi Roth was born in Milan in 1940. Mr. Roth has been a Director of Telecom Italia since May 6, 2004. He began his career in the Pirelli Group, which he left to join Metropolitana Milanese as head of the Planning Department. From 1980 onwards he ran a number of medium-sized firms in the manufacturing and property sectors as General Manager or Managing Director. From 1986 until 1993 he was Managing Director of Finanziaria Ernesto Breda S.p.A. and then, until 2001, Chairman and Managing Director of Breda Costruzioni Ferroviarie S.p.A.. In addition, from 1996 to 1998 he was also Chairman of Società Ferrovie Nord Milano S.p.A. and Società Ferrovie Nord Milano Esercizio S.p.A.. From May 1998 to December 2000, Mr. Roth was managing director of Ansaldo Trasporti S.p.A. and set up the Transport Sector of Finmeccanica S.p.A.. In January 2001 he became Chairman of the Milan Fair Foundation, which controls Fiera Milano S.p.A. and Sviluppo Sistema Fiera. He is Chairman of Terna S.p.A. and Deputy Chairman of Cassa Depositi e Prestiti S.p.A..

Table of Contents**Item 6. Directors, Senior Management and Employees****Executive Officers****6.2 EXECUTIVE OFFICERS**

As of May 10, 2006, the executive officers of Telecom Italia and their respective ages, positions and year of appointment as executive officers were as follows:

Name	Age	Position	Appointed
Marco Tronchetti Provera	58	Executive Chairman	2001
Carlo Orazio Buora	60	Managing Director	2001
Riccardo Ruggiero	45	Managing Director of Operations General Manager of Telecom Italia	2005 2002
Giuseppe Sala	48	General Manager of Telecom Italia Head of Top Client and Customer Service of Operations	2003 2005
Central Functions:			
Gustavo Bracco	58	Head of Human Resources and Organization	2001
Enrico Parazzini	62	Head of Finance, Administration and Control	2001
Francesco Chiappetta	45	General Counsel Head of Corporate and Legal Affairs	2002 2005
Germanio Spreafico	53	Head of Purchasing	2001
Operation Functions:			
Stefano Pileri	50	Chief Technology Officer Head of Technology	2005 2005
Luca Luciani	38	Head of Sales	2005
Massimo Castelli	46	Chief Marketing Officer Head of Market Development	2005 2005
Business Units:			
Enrico Parazzini	62	Head of Media Business Unit Managing Director of Telecom Italia Media	2003 2003

The following are the selected biographical data of the executive officers, other than Directors:

For the biographical data of Mr. Tronchetti Provera, Mr. Buora and Mr. Ruggiero, please see above under 6.1 Directors .

Gustavo Bracco: Mr. Bracco was born in Turin, Italy, in 1948. On October 1, 2001, he became Head of Telecom Italia Group Human Resources. Mr. Bracco began his career at Fiat in 1972, working for the Trade Union Relations Central Management. In 1976, he was appointed Personnel Manager at the Mirafiori factory. In 1977, he transferred to Toro Assicurazioni as Head of Industrial Relations and Labour Disputes, under the aegis of Central Personnel Management. He joined the Turin Industrial Union in 1979, where he worked until 1982, initially at the Research Office before moving to the Trade Union Service, where he rose through the ranks to the position of Head. Between 1983 and 1987, he worked at Cinzano, Saiag and Carello, with responsibility for Personnel and External Relations. In 1988, he returned to the Fiat Group as Head of Personnel and Organization at the Engine Control Division. He took on the same role at CEAC in 1991 and at Fidis in 1994. He was appointed Head of Group Trade Union Relations in 1996. In 1998, Mr. Bracco went to work in London for New Holland as Head of Personnel and Organization, a position

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he subsequently filled in Chicago for Case-New Holland. He joined Pirelli in December 2000 as Group Head of Human Resources. Mr. Bracco is Chairman of Telecom Italia Learning Services S.p.A. and Director of Telecom Italia Audit and Compliance Services S.c.a.r.l..

Massimo Castelli: Mr. Castelli was born in Rome, in 1959. On October 5, 2005, Mr. Castelli was appointed Telecom Italia S.p.A. Chief Marketing Officer. Mr. Castelli began his career in 1985 in Olivetti S.p.A., Commercial Division Italia, Marketing. In 1996 Mr. Castelli was appointed Vice President Marketing in Infostrada. Mr. Castelli began his career in Telecom Italia Group on October 10, 2001, when he was appointed Vice President Marketing of Wireline; in 2004 he became Executive Vice President Marketing & Sales of Telecom Italia Mobile and, on April 15, 2005, Chief Operating Officer of Tim Italia S.p.A..

Table of Contents**Item 6. Directors, Senior Management and Employees****Executive Officers**

Francesco Chiappetta: Mr. Chiappetta was born in Rome, Italy, in 1960. Mr. Chiappetta was appointed Telecom Italia S.p.A. General Counsel on August 1, 2002 and Head of Corporate and Legal Affairs since November 25, 2005. He is also the Secretary to the Telecom Italia Board of Directors. Mr. Chiappetta began his career in 1983 at CONSOB, Italy's stock market and corporate regulatory body. Over the next ten years he held a number of positions at this organization, including Chief of the Regulation Office. Between 1998 and July 2001 he worked as Deputy General Manager for Assonime, the Association of Italian Corporations, with responsibility for company law and capital markets. In August 2001 he joined the Pirelli & C. Group as Head of Legal and Corporate Affairs, a position he filled until joining the Telecom Italia Group. From 1989 to 2005 he worked in academia, holding courses and lectures at leading Italian universities including La Sapienza in Rome, Università di Roma Tre and the Luigi Bocconi University in Milan. Mr. Chiappetta has widely published both on company and securities law. At the present time he is also Chairman of the Company Law Working Group of Unice (Union of Industrial and Employers' Confederation of Europe). Since April 2005, Mr. Chiappetta is a member of the Corporate Governance Advisory Group, a group of experts recently established by the European Commission.

Luca Luciani: Mr. Luciani was born in Padova, in 1967. Since October 5, 2005, Mr. Luciani has been Responsible for the Indirect Sales channels of the Group. Mr. Luciani began his career in Procter & Gamble in 1990; in 1994, he became Consulting Manager of Bain & Company Consulting and in 1998 Group Controller of Enel Group. He joined the Telecom Italia Group in 1999 as Group Controller; in 2002 he was appointed Chief Financial Officer of TIM and, in 2003, he was appointed Executive Assistant to the Chairman of Telecom Italia. In 2004 he became Responsible for Marketing activities of Telecom Italia Mobile S.p.A. and from 2004 he was Responsible for IT and Network Services and coordination of International activities. In 2005, he was appointed Chief Marketing Officer of TIM.

Enrico Parazzini: Mr. Parazzini was born in Milan, Italy, in 1944. Since August 1, 2003 he has been Managing Director of Telecom Italia Media, maintaining also his position as Chief Financial Officer of the Telecom Italia Group. Since October 1, 2001 he has been CFO of the Telecom Italia Group. After graduating in Economy and Commerce at Milan's Luigi Bocconi University, he commenced his professional career in 1968 as Junior Auditor at Arthur Andersen and in 1969 changed to General Electric, where he worked in the Finance Department. In 1970 he passed to Honeywell Information Systems Italia, a company where in the course of the next twenty years he held positions of growing responsibility: Financial Planning Director from 1975 to 1980; Director of Administration and Control from 1981 to 1986 and Chief Financial Officer from 1987 to 1990. A year later, following the disposal of Honeywell's activities to Bull, Mr. Parazzini was appointed General Manager of Administration, Control, Information Technology Systems and Logistics. In May 1992 he joined Pirelli as Director of Planning and Control (Group Controller), and participated to the turnaround of the Group and, more particularly, to the reorganization of the planning and control system. Between 1996 and 1999 he was in charge of Planning and Control, Administration, Group Purchases and Risk Management. In 2000 he was appointed Chief Financial Officer of Pirelli's Cable and Systems Sector. From 1994 to 2000 he was visiting lecturer at the Luigi Bocconi University for the course on Planning and Control in Multinational Groups; since 2002 he has been acting as Professor for the Master in Corporate Finance at the Luigi Bocconi University's Management School (*Scuola di Direzione Aziendale SDA*).

Stefano Pileri: Mr. Pileri was born in Rome in 1955. He has been in SIP (Italian Telecom Operator) since 1982 where he assumed growing responsibilities, during the years, in the Network Management Systems Department. From 1993 to 1994 he was responsible for the Network Development and Operations in the Emilia-Romagna region, and in 1997 he became Responsible for Network Planning, Engineering and Marketing in the Network Division of Telecom Italia. In March 1998 he became Responsible of the Telecom Italia Wireline Network and in June 2005 he was also appointed Chief Technology Officer of the Telecom Italia Group, directly reporting the Chairman, with the responsibility to drive and coordinate the fixed-mobile integration and the overall technological network development.

Giuseppe Sala: Mr. Sala was born in Milan, Italy, in 1958. He was appointed General Manager Top Clients & Customer Services of Telecom Italia Group on October 5, 2005. Mr. Sala began his career at Pirelli in 1983 at the Planning and Control Department.

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Over the next 10 years he was promoted through the company, holding the position of Planning and Control Manager and Head of Administration and Control. In 1994 he was appointed Head of Strategic Planning and Control of Pirelli's Tyres Sector. In 1998, Mr. Sala became Managing Director of Pirelli S.p.A. Tyres Italian Division, and in 2001 he filled the position of Senior Vice President Operations Tyres Sector of Pirelli's Group. During 2002 he held the position of Chief Financial Officer of TIM S.p.A.. In October 2002

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Executive Officers

he was appointed Assistant to the Chairman of the Telecom Italia Group. He became General Manager of the Wireline Business Unit of Telecom Italia in June 2003.

Germanio Spreafico: Mr. Spreafico was born in Lecco, in 1952. He was appointed Head of Telecom Italia Group Purchasing on October 1, 2001. He began his career in 1977 at the Pirelli Financial Division, where he worked for 10 years, during which time he was promoted through various positions in domestic and international finance and ultimately took charge of Italian market financial operations. Subsequent to this he moved to the Cable sector, initially as Chief Financial Officer of the Italian company, before taking on the same role for the French company. In 1997, he became Chief Financial Officer of the Group Cable Industry Holding Company, where he also took on the position of Chief Purchasing Officer. At the present time, Mr. Spreafico is Chairman of Telenergia S.r.l., Consorzio Energia, Olivetti Multiservices S.p.A. and Deputy Chairman of Pirelli Cavi & Sistemi S.p.A., the holding company for the Pirelli group Cable division, of which he was Head of Administration and Control and, from February 2000, Head of Purchasing.

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Item 6. Directors, Senior Management and Employees

Board Of Auditors

6.3 BOARD OF AUDITORS

The following table lists the members of the Telecom Italia Board of Auditors as of May 10, 2006, including the Alternate Auditors, with their respective positions and year of appointment. The current Telecom Italia Board of Auditors was appointed by the shareholders' meeting on April 13, 2006.

<u>Name</u>	<u>Position</u>	<u>Appointed</u>
Paolo GOLIA(1)(2)	Chairman	2006
Stefano MEROI(1)	Auditor	2006
Salvatore SPINIELLO(3)	Auditor	2006
Ferdinando SUPERTI FURGA(3)	Auditor	2006
Gianfranco ZANDA(4)	Auditor	2006
Enrico LAGHI(3)	Alternate Auditor	2006
Enrico Maria BIGNAMI(1)(2)	Alternate Auditor	2006

(1) Elected by minority shareholders.

(2) Reappointed in 2006; member of the Board of Auditors since 2000.

(3) Reappointed in 2006; member of the Board of Auditors since 2003.

(4) Reappointed in 2006; member of the Board of Auditors since 1997.

The positions held by the members of the Board of Auditors in other listed companies are shown below:

Paolo Golia	
Stefano Meroi	
Salvatore Spiniello	Director of Fondiaria Sai S.p.A. and Immobiliare Lombarda S.p.A.; member of the Board of Auditors of Edison S.p.A., Telecom Italia Media S.p.A. and Unicredit Banca S.p.A..
Ferdinando Superti Furga	Director of Parmalat S.p.A. and Risanamento S.p.A.; member of the Board of Auditors of Arnoldo Mondadori Editore S.p.A. and Edison S.p.A..
Gianfranco Zanda	

For a detailed description of Telecom Italia's Corporate Governance, including activities and responsibilities of the Board of Auditors (acting as Audit Committee of the Company), see Item 10. Additional Information 10.1 Corporate Governance .

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External Auditors

6.4 EXTERNAL AUDITORS

According to Italian law, the Shareholders Meeting held on May 6, 2004 appointed Reconta Ernst & Young as the audit firm of the Company for the three year period 2004-2006, taking into consideration the favorable recommendation of the Board of Auditors.

Italian audit principles require that, in cases of corporate groups, the audit firm of Telecom Italia should carry out the audit of the group's most important entities in terms of the nature of operations, in such a way that it can act as the main group audit firm and express a professional evaluation of the financial statements in their entirety. In addition, the specific procedure set forth by Telecom Italia (the Group Procedure for the Appointment of External Auditors) provides that the auditor of Telecom Italia is the principal auditor of the entire group headed by Telecom Italia and consequently is the auditor to be preferred in the conferral of appointments by subsidiaries for mandatory auditing.

As a result, the Ernst & Young audit network presently is the sole audit firm for all of the companies of the Telecom Italia Group.

Table of Contents**Item 6. Directors, Senior Management and Employees****Employees****6.5 EMPLOYEES**

The following table sets out the number of employees of the Telecom Italia Group at December 31, 2004 and 2005 by Business Unit:

	Number of employees	
	as of December 31,	
	2004	2005
Wireline	54,090	55,990
Mobile	18,743	20,767
Media	1,077	886
Olivetti	2,109	1,750
Other activities	6,601	6,091
Consolidated Total	82,620	85,484

As of December 31, 2005, the Telecom Italia Group employed 86,531 employees (94,022 units at December 31, 2004) including 1,047 units (11,042 employees at December 31, 2004) relating to discontinued operations/assets held for sale.

The following table summarizes the changes during the year 2005 relating to the number of employees:

Employees at December 31, 2004(*)	Changes during the year					Employees at December 31, 2005(*)
	Hired	Terminated employment	Increase of temporary employment	Change in scope of consolidation	Total changes	
94,022	7,735	(5,603)	732	(10,355)	(7,491)	86,531

(*) Include 2,650 and 3,382 temporary employees at December 31, 2004 and 2005, respectively.

As of December 31, 2005, the Telecom Italia Group had 86,531 employees. Compared to December 31, 2004 total employment was lower by 7,491, mainly attributable to the following factors:

- the hiring of 7,735 employees (of which 514 relating to discontinued operations/assets held for sale), the terminations of 5,603 employees (of which 576 relating to discontinued operations/assets held for sale), and the increase of 732 temporary employees;
- the sale of the Entel Chile group (a decrease of 4,166 units), the Finsiel group (a decrease of 3,972 units), the TIM Hellas (a decrease of 1,495 units) and TIM Perù (a decrease of 653 units);
- the changes in the scope of consolidation as a result of the acquisition of Liberty Surf Group (an increase of 614 units), the setting up of TI Sparkle France (an increase of 24 units), the sales of Televoice (a decrease of 169 units), Innovis (a decrease of 222 units), Cell-Tell (a decrease of 112 units), Databank (a decrease of 86 units), Med 11C-1 (a decrease of 14 units), as well as the sale of the Territorial security centers business segment to Tecnosis S.p.A. by the Parent company (a decrease of 104 units).

The following table sets out the number of employees of the Telecom Italia Group at December 31, 2005 broken down by geographical area and function:

	Executives	Middle Management	White collars	Blue collars	Temporary employees	Total
Italy	1,395	4,227	63,786	660	1,919	71,987
Rest of Europe	46	210	1,781	1	782	2,820
North America	4	26	18	2		50
Central and South America	28	414				