

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*                     |

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

**None**

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(Title of Class)

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

**None**

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(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

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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

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\* 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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**Introduction**

- 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.

|  |   |
|--|---|
| <b>EU</b>  | means the European Union.   |
| <b>IFRS</b>  | means International Financial Reporting Standards, as adopted by the European Commission for use in the European Union.   |
| <b>Merger</b>  | means the merger of Old Telecom Italia into Olivetti, which became effective on August 4, 2003.   |
| <b>Mobile Italy</b>                                    | means the unit which operates our Italian mobile business.  |
| <b>Old Telecom Italia and Old Telecom Italia Group</b> | means Telecom Italia and its consolidated subsidiaries as they existed immediately prior to the effective date of the Merger.   |
| <b>Olivetti</b>  | means Olivetti S.p.A., the holding company and controlling shareholder of Old Telecom Italia.   |
| <b>Olivetti Group</b>                                  | means Olivetti and its consolidated subsidiaries, including Old Telecom Italia.   |
| <b>Ordinary Shares</b>                                 | means the Ordinary Shares, 0.55 par value each, of Telecom Italia.  |
| <b>Savings Shares</b>                                  | means the Savings Shares, 0.55 par value each, of Telecom Italia.   |
| <b>Telecom Italia</b>                                  | means the entity which resulted from the Merger.  |
| <b>Telecom Italia Group</b>                            | means the Company and its consolidated subsidiaries.  |
| <b>Telecom Italia Media</b>                            | 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 1. Identity of Directors, Senior Management and Advisers**

**Item 2. Offer Statistics and Expected Timetable**

**Item 3. Key Information**

**Risk Factors**

**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**

**Risk Factors**

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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**Item 3. Key Information**

**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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**Item 3. Key Information**

**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.

| <b>Calendar Period</b>      | <b>High</b> | <b>Low</b> | <b>Average(1)</b> | <b>At Period end</b> |
|-----------------------------|-------------|------------|-------------------|----------------------|
| 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               |
| <b>Monthly Amounts</b>      |             |            |                   |                      |
| 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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**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.

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|  | 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) |
| <b>Statement of Operations Data in accordance with IFRS:</b>   |  |               |   |
| <b>Revenues</b>  | <b>28,292</b>  | <b>29,919</b> | <b>35,430</b>   |
| <b>Operating income</b>  | <b>7,603</b>   | <b>7,499</b>  | <b>8,880</b>  |
| <b>Net income from continuing operations</b>   | <b>2,952</b>   | <b>3,140</b>  | <b>3,718</b>  |
| Net income (loss) from discontinued operations/assets held for sale  | (118)  | 550           | 651   |
| <b>Net income</b>  | <b>2,834</b>   | <b>3,690</b>  | <b>4,369</b>  |
| <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>  |
| <b>Financial Ratios in accordance with IFRS:</b>   |  |               |   |
| 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  |
| <b>Basic and Diluted earnings per Share(3):</b>  |  |               |   |
| <b>Ordinary Share</b>  | <b>0.11</b>  | <b>0.17</b>   | <b>0.20</b>   |
| <b>Savings Share</b>   | <b>0.12</b>  | <b>0.18</b>   | <b>0.21</b>   |
| <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>   |
| <b>Dividends:</b>  |  |               |   |

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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,<br>except percentages<br>and employees) |               | (millions of U.S.<br>dollars, except<br>percentages and<br>employees)(1) |
| <b>Balance Sheet Data in accordance with IFRS:</b>   |  |               |  |
| <b>Total assets</b>  | <b>81,834</b>  | <b>96,010</b> | <b>113,695</b>   |
| <b>Shareholders equity:</b>  |  |               |  |
| Shareholders equity attributable to the Group  | 16,248   | 25,662        | 30,389   |
| Shareholders equity attributable to Minority interests   | 4,550  | 1,323         | 1,567  |
| <b>Total shareholders equity</b>   | <b>20,798</b>  | <b>26,985</b> | <b>31,956</b>  |
| <b>Total liabilities</b>   | <b>61,036</b>  | <b>69,025</b> | <b>81,739</b>  |
| <b>Total shareholders equity and liabilities</b>   | <b>81,834</b>  | <b>96,010</b> | <b>113,695</b>   |
| <b>Share capital(5)</b>  | <b>8,809</b>   | <b>10,599</b> | <b>12,551</b>  |
| <b>Financial Ratios in accordance with IFRS:</b>   |  |               |  |
| • 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) |
| <b>Statement of Operations Data in accordance with U.S. GAAP:</b>   |  |              |              |              |              |   |
| • 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  |
| • <b>Net income (loss)(7)</b>   | <b>(4,006)</b>                               | <b>1,956</b> | <b>1,841</b> | <b>1,541</b> | <b>1,939</b> | <b>2,296</b>  |
| <b>Basic and Diluted earnings per Ordinary Share(8):</b>  |  |              |              |              |              |   |
| • 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  |
| • <b>Net income (loss) per Ordinary Share</b>   | <b>(1.17)</b>                                | <b>0.48</b>  | <b>0.20</b>  | <b>0.09</b>  | <b>0.10</b>  | <b>0.12</b>   |
| <b>Basic and Diluted earnings per Savings Share(8):</b>   |  |              |              |              |              |   |
| • 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  |
| • <b>Net income (loss) per Savings Share</b>  |  |              | <b>0.21</b>  | <b>0.10</b>  | <b>0.11</b>  | <b>0.13</b>   |

**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) |
| <b>Balance Sheet Data in accordance with U.S. GAAP:</b> |                    |               |                |                |                |                               |
| <b>Total assets</b>                                     | <b>104,212</b>     | <b>93,367</b> | <b>108,335</b> | <b>106,919</b> | <b>123,304</b> | <b>146,017</b>                |
| <b>Shareholders equity(9)</b>                           | <b>13,611</b>      | <b>15,221</b> | <b>35,067</b>  | <b>34,827</b>  | <b>44,631</b>  | <b>52,852</b>                 |
| <b>Total liabilities(10)</b>                            | <b>90,601</b>      | <b>78,146</b> | <b>73,268</b>  | <b>72,092</b>  | <b>78,673</b>  | <b>93,165</b>                 |
| <b>Total shareholders equity and liabilities</b>        | <b>104,212</b>     | <b>93,367</b> | <b>108,335</b> | <b>106,919</b> | <b>123,304</b> | <b>146,017</b>                |
| <b>Share capital(5)</b>                                 | <b>8,570</b>       | <b>8,630</b>  | <b>8,798</b>   | <b>8,809</b>   | <b>10,599</b>  | <b>12,551</b>                 |

|   | As of December 31, |        |        |        |        |        |
|---|--------------------|--------|--------|--------|--------|--------|
|   | 2001               | 2002   | 2003   | 2004   | 2005   |        |
| <b>Statistical Data:</b>  |                    |        |        |        |        |        |
| <b>Wireline:</b>  |                    |        |        |        |        |        |
| 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   |        |
| <b>Network infrastructure in Italy:</b>   |                    |        |        |        |        |        |
| • 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    |        |
| <b>Network infrastructure abroad:</b>   |                    |        |        |        |        |        |
| • European backbone (km of fiber optics)  | 36,600             | 36,600 | 39,500 | 39,500 | 51,000 |        |
| <b>Mobile:</b>  |                    |        |        |        |        |        |
| 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   |        |
| <b>Media:</b>   |                    |        |        |        |        |        |
| 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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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.

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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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**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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**Business**

**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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**Business**

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:

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- (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<br>(1)(2) | Mobile | Media<br>(1) | Olivetti<br>(4) | Other<br>activities<br>(2)(3) | Adjustments<br>and<br>eliminations | Consolidated<br>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<br>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         |
| <b>Statistical Data:</b>  |                    |              |              |
| <b>Wireline:</b>  |                    |              |              |
| 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> |
| <b>Broadband Access(2):</b>   |                    |              |              |
| • 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         |
| <b>Network infrastructure in Italy:</b>   |                    |              |              |
| • 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          |
| <b>Network infrastructure abroad:</b>   |                    |              |              |
| • European backbone (km of fiber optics)  | 39,500             | 39,500       | 51,000       |
| <b>Mobile:</b>  |                    |              |              |
| 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         |
| <b>Media:</b>   |                    |              |              |
| 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:

| <b>Telecom Italia Wireline</b> | <b>WIRELINE<br/>National Subsidiaries</b> | <b>International Subsidiaries</b>       |
|--------------------------------|---|---|
| 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         |
| <b>Statistical Data:</b>  |                    |              |              |
| <b>Wireline:</b>  |                    |              |              |
| 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> |
| <b>Broadband Access(2):</b>   |                    |              |              |
| • 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         |
| <b>Network infrastructure in Italy:</b>   |                    |              |              |
| • 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          |
| <b>Network infrastructure abroad:</b>   |                    |              |              |
| • 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  |
| <b>Retail Traffic(3):</b>  |                         |       |       |
| 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 (%) <sup>(1)</sup>              | 8.1                     | 8.4   | 4.7   |
| Total incoming traffic (millions of minutes)               | 3,299                   | 3,445 | 3,480 |
| Growth in incoming traffic (%) <sup>(1)</sup>              | (14.1)                  | 4.4   | 1.0   |
| Total international transit traffic (millions of minutes)  | 4,382                   | 5,452 | 6,051 |
| Growth in international transit traffic (%) <sup>(1)</sup> | 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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**Business Units**

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:

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

(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> |
|                                       | <b>(number of customers in thousands)</b> |             |             |
| 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      |
|                                       | <b>(in %)</b>                             |             |             |
| 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       |
|                                       | <b>(in euro)</b>                          |             |             |
| 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 costumers 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.

## Edgar Filing: TELECOM ITALIA S P A - Form 20-F

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:

| <b>MEDIA</b>          |             |
|-----------------------|-------------|
| <b>TV</b>             | <b>News</b> |
| La7                   | TM News     |
| MTV                   |             |
| TI Media Broadcasting |             |



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**Item 4. Information On The Telecom Italia Group**

**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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**Item 4. Information On The Telecom Italia Group**

**Business Units**

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:

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**OLIVETTI**

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Olivetti S.p.A.(1)

- Olivetti I-Jet S.p.A.
  
- Wirelab S.p.A.(2)
  
- Olivetti International B.V.

(foreign sales companies)

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(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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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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**Business Units**

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(\*).

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(\*) 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.

| <b>Basket</b>    | <b>Content</b>   | <b>Annual reductions for<br/>2007 and 2008</b> |
|------------------|--|--|
| 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:

| <b>Operator</b> | <b>Current<br/>charge*<br/>eurocents/min</b> | <b>From<br/>July 1, 2006<br/>eurocents/min</b> | <b>From<br/>July 1, 2007</b> | <b>From<br/>July 1,<br/>2008</b> | <b>Cost oriented<br/>target charge by<br/>July 1, 2008<br/>eurocents/min</b> |
|-----------------|--|--|------------------------------|----------------------------------|--|
| 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.

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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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Glossary Of Selected Telecommunications Terms

**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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**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                                       |
| <b>Total</b>                                       | <b>17,853</b>           | <b>1,653</b> | <b>19,506</b>                        | <b>100.0</b>                              | <b>16,443</b>           | <b>1,598</b> | <b>18,041</b>                        | <b>100.0</b>                              |

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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**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.

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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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**Critical Accounting Policies And Estimates**

**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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**Item 5. Operating And Financial Review And Prospects**

**Results Of Operations For The Two Years Ended December 31, 2005**

**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:

|   | <b>As of December 31,</b> |               |
|---|---------------------------|---------------|
|   | <b>2004</b>               | <b>2005</b>   |
|   | (millions of Euro)        |               |
| <b>GROSS FINANCIAL DEBT</b>   |                           |               |
| <b>Non-current financial liabilities (Long-term debt)</b>   |                           |               |
| Financial payables  | 36,862                    | 40,252        |
| Finance lease liabilities   | 1,860                     | 1,894         |
| Other financial liabilities   | 3                         |               |
|   | <b>38,725</b>             | <b>42,146</b> |
| <b>Current financial liabilities (Short-term debt), excluding financial debt relating to discontinued operations/assets held for sale</b> |                           |               |
| Financial payables  | 4,168                     | 9,572         |
| Finance lease liabilities   | 227                       | 234           |
| Other financial liabilities   | 5                         | 6             |
|   | <b>4,400</b>              | <b>9,812</b>  |
| <b>Financial debt relating to discontinued operations/assets held for sale</b>  | <b>188</b>                | <b>143</b>    |
| <b>TOTAL GROSS FINANCIAL DEBT (A)</b>   | <b>43,313</b>             | <b>52,101</b> |
| <b>FINANCIAL ASSETS</b>   |                           |               |
| <b>Non-current financial assets</b>   |                           |               |
| Securities other than equity investments  | 7                         | 8             |
| Financial receivables and other non-current financial assets  | 386                       | 988           |
|   | <b>393</b>                | <b>996</b>    |
| <b>Current financial assets, excluding financial assets relating to discontinued operations/assets held for sale</b>                      |                           |               |
| Securities other than equity investments  | 457                       | 378           |
| Financial receivables and other current financial assets  | 662                       | 509           |
| Cash and cash equivalents   | 8,855                     | 10,323        |
|   | <b>9,974</b>              | <b>11,210</b> |
| <b>Financial assets relating to discontinued operations/assets held for sale</b>  | <b>84</b>                 | <b>37</b>     |
| <b>TOTAL FINANCIAL ASSETS (B)</b>   | <b>10,451</b>             | <b>12,243</b> |

|                                 |               |               |
|---------------------------------|---------------|---------------|
| <b>NET FINANCIAL DEBT (A-B)</b> | <b>32,862</b> | <b>39,858</b> |
|---------------------------------|---------------|---------------|

### 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)      |                 |
| <b>Statement of Operations Data in accordance with IFRS:</b>                  |                         |                 |
| Revenues  | 28,292                  | 29,919          |
| Other income  | 1,099                   | 678             |
| <b>Total operating revenues and other income</b>                              | <b>29,391</b>           | <b>30,597</b>   |
| 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)            |
| <b>Total operating expenses</b>   | <b>(21,788)</b>         | <b>(23,098)</b> |
| <b>Operating income</b>   | <b>7,603</b>            | <b>7,499</b>    |
| 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)         |
| <b>Income from continuing operations before taxes</b>                         | <b>5,606</b>            | <b>5,535</b>    |
| Income taxes  | (2,654)                 | (2,395)         |
| <b>Net income from continuing operations</b>                                  | <b>2,952</b>            | <b>3,140</b>    |
| Net income (loss) from discontinued operations/assets held for sale           | (118)                   | 550             |
| <b>Net income</b>   | <b>2,834</b>            | <b>3,690</b>    |
| <i>Of which:</i>  |                         |                 |
| • Net income attributable to the Group  | 1,815                   | 3,216           |
| • Net income attributable to Minority interests                               | 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<br>(1)(2) | Mobile | Media<br>(1) | Olivetti<br>(4) | Other<br>activities<br>(2)(3) | Adjustments<br>and<br>Eliminations | Consolidated<br>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:

|  |                  | <b>Discontinued operations/Assets held for sale</b> |              |                                  |                      |                  |   |              |
|--|------------------|---|--------------|----------------------------------|----------------------|------------------|---|--------------|
|  |                  | <b>Mobile</b>                                       | <b>Media</b> | <b>Entel<br/>Chile<br/>group</b> | <b>IT<br/>Market</b> | <b>Sub-Total</b> | <b>Others,<br/>adjustments<br/>and<br/>eliminations</b> | <b>Total</b> |
|  |                  | <b>(1)</b>  | <b>(2)</b>   | <b>group</b>                     | <b>Market</b>        | <b>Sub-Total</b> | <b>(3)</b>  | <b>Total</b> |
|  |                  | <b>(millions of Euro)</b>                           |              |                                  |                      |                  |   |              |
| 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       |

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(\*) 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%                       |
| <b>Total revenues</b>                  | <b>31,536</b>     | <b>28,292</b>            | <b>100.0%</b>              | <b>33,077</b>     | <b>29,919</b>            | <b>100.0%</b>              |

(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:

| <b>Geographic area</b>             | <b>Year ended December 31,</b>                |               |               |               |
|------------------------------------|---|---------------|---------------|---------------|
|                                    | <b>2004</b>                                   |               | <b>2005</b>   |               |
|                                    | <b>(millions of Euro, except percentages)</b> |               |               |               |
| 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%          |
| <b>Total consolidated revenues</b> | <b>28,292</b>                                 | <b>100.0%</b> | <b>29,919</b> | <b>100.0%</b> |

**V OTHER INCOME**

Other income amounted to 678 million, a decrease of 421 million compared to 2004. Details are as follows:

|   | <b>Year ended December 31,</b> |             |
|---|--------------------------------|-------------|
|   | <b>2004</b>                    | <b>2005</b> |
|   | <b>(millions of Euro)</b>      |             |
| 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         |
| <b>Total</b>  | <b>1,099</b>                   | <b>678</b>  |

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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%         |
|   | <b>21,788</b>                          | <b>77.0%</b> | <b>23,098</b> | <b>77.2%</b> |

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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)      |               |
| <b>Purchases of materials and merchandise for resale</b>         | <b>(A) 2,203</b>        | <b>2,506</b>  |
| <b>Costs of services:</b>  |                         |               |
| - 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>(B) 8,661</b>        | <b>9,327</b>  |
| <b>Lease and rental costs:</b>                                   |                         |               |
| - 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           |
|  | <b>(C) 948</b>          | <b>1,104</b>  |
| <b>Total purchases of materials and external services</b>        | <b>(A+B+C) 11,812</b>   | <b>12,937</b> |

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)      |              |
| <b>Personnel costs at payroll:</b>   |                         |              |
| - 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           |
|  | <b>(A)</b>              | <b>3,615</b> |
| <b>Temporary labour costs</b>  | <b>(B)</b>              | <b>38</b>    |
| <b>Miscellaneous expenses for personnel and for other labour-related services rendered:</b>  |                         |              |
| - 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            |
|  | <b>(C)</b>              | <b>199</b>   |
| <b>Total personnel costs</b>   | <b>(A+B+C)</b>          | <b>3,852</b> |
|  |                         | <b>4,142</b> |

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    |

|                                   |               |               |
|-----------------------------------|---------------|---------------|
| <b>Total employees at payroll</b> | <b>77,649</b> | <b>77,382</b> |
| <b>Temporary employees</b>        | <b>1,953</b>  | <b>2,487</b>  |
|                                   | <hr/>         | <hr/>         |
| <b>Total employees</b>            | <b>79,602</b> | <b>79,869</b> |
|                                   | <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:

|   | <b>Year ended December 31,</b> |              |
|---|--------------------------------|--------------|
|   | <b>2004</b>                    | <b>2005</b>  |
|   | <b>(millions of Euro)</b>      |              |
| 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/>        |
| <b>Total other operating expenses</b>               | <b>1,603</b>                   | <b>1,468</b> |
|   | <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)      |            |
| <b>Intra-group revenues for the sale of:</b>         |                         |            |
| Intangible assets with a finite life                 | 49                      | 105        |
| Tangible assets                                      | 18                      | 29         |
|  | <b>(A)</b>              | <b>67</b>  |
| <b>Capitalized internal construction costs on:</b>   |                         |            |
| Intangible assets with a finite life                 | 473                     | 182        |
| Property, plant and equipment owned                  | 173                     | 155        |
|  | <b>(B)</b>              | <b>646</b> |
| <b>Total capitalized internal construction costs</b> | <b>(A+B)</b>            | <b>713</b> |
|  |                         | <b>471</b> |

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)   |                         |              |
| <b>Amortization of Intangible assets with a finite life:</b>     |                         |              |
| Industrial patents and intellectual property rights              | 1,106                   | 1,414        |
| Concessions, licenses, trademarks and similar rights             | 224                     | 253          |
| Other intangible assets  | 16                      | 17           |
|  | <b>(A) 1,346</b>        | <b>1,684</b> |
| <b>Depreciation of Tangible assets owned:</b>                    |                         |              |
| 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>(B) 3,324</b>        | <b>3,416</b> |
| <b>Depreciation of Tangible assets held under finance lease:</b> |                         |              |
| Civil and industrial buildings                                   | 93                      | 93           |
| Plant and equipment  |                         | 1            |
| Aircrafts and ships  | 4                       | 4            |
| Other assets   | 41                      | 34           |
|  | <b>(C) 138</b>          | <b>132</b>   |
| <b>Total depreciation and amortization</b>                       | <b>(A+B+C) 4,808</b>    | <b>5,232</b> |

- **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:

|  | <b>Year ended December 31,</b> |             |
|--|--------------------------------|-------------|
|  | <b>2004</b>                    | <b>2005</b> |
|  | (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)        |
| <b>Total share of earnings of equity investments accounted for using the equity method</b> | <b>(5)</b>                     | <b>23</b>   |

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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:

|   | <b>Year ended December 31,</b> |                |
|---|--------------------------------|----------------|
|   | <b>2004</b>                    | <b>2005</b>    |
|   | <b>(millions of Euro)</b>      |                |
| Financial income                                | 2,205                          | 3,144          |
| Financial expenses                              | (4,197)                        | (5,131)        |
| <b>Total financial income and expenses, net</b> | <b>(1,992)</b>                 | <b>(1,987)</b> |

**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   |
| <b>Subscription and Customers:</b>   |                         |        |
| 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  |
| <b>Broadband Access(3):</b>  |                         |        |
| • in Italy (thousands)   | 4,010                   | 5,707  |
| • in Europe (thousands)  | 420                     | 1,313  |
| Voice Offers in Italy (thousands)(4)   | 5,883                   | 6,392  |
| <b>Wireline Traffic:</b>   |                         |        |
| 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   |
| <b>Retail Traffic(7):</b>  |                         |        |
| 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.

| <b>Mobile</b>                   | <b>Year ended December 31,</b>                             |             |
|---------------------------------|--|-------------|
|                                 | <b>2004</b>  | <b>2005</b> |
|                                 | <b>(millions of Euro, except percentage and employees)</b> |             |
| 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.

| <b>Mobile Italy</b>             | <b>Year ended December 31,</b>                       |             |
|---------------------------------|--|-------------|
|                                 | <b>2004</b>  | <b>2005</b> |
|                                 | (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.

| <b>Mobile Brazil</b>            | <b>Year ended December 31,</b>                       |             |
|---------------------------------|--|-------------|
|                                 | <b>2004</b>  | <b>2005</b> |
|                                 | (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.

| <b>Media</b>                    | <b>Year ended December 31,</b>                      |             |
|---------------------------------|---|-------------|
|                                 | <b>2004</b>   | <b>2005</b> |
|                                 | (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.

| <b>Olivetti(1)</b>              | <b>Year ended December 31,</b>                             |             |
|---------------------------------|--|-------------|
|                                 | <b>2004</b>  | <b>2005</b> |
|                                 | <b>(millions of Euro, except percentage and employees)</b> |             |
| 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           |
| <b>Aggregate cash flows (A)</b>   | <b>3,492</b>       | <b>1,150</b> |
| <b>Net cash and cash equivalents (*) at the beginning of the year (B)</b>       | <b>5,211</b>       | <b>8,667</b> |
| Net effect of foreign currency translation on net cash and cash equivalents (C) | (36)               | 141          |
| <b>Net cash and cash equivalents (*) at the end of the year (D=A+B+C)</b>       | <b>8,667</b>       | <b>9,958</b> |

(\*) 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) |               |
| <b>GROSS FINANCIAL DEBT</b>   |                    |               |
| <b>Non-current financial liabilities (Long-term debt)</b>   |                    |               |
| Financial payables  | 36,862             | 40,252        |
| Finance lease liabilities   | 1,860              | 1,894         |
| Other financial liabilities   | 3                  |               |
|   | <b>38,725</b>      | <b>42,146</b> |
| <b>Current financial liabilities (Short-term debt), excluding financial debt relating to discontinued operations/assets held for sale</b> |                    |               |
| Financial payables  | 4,168              | 9,572         |
| Finance lease liabilities   | 227                | 234           |
| Other financial liabilities   | 5                  | 6             |
|   | <b>4,400</b>       | <b>9,812</b>  |
| <b>Financial debt relating to discontinued operations/assets held for sale</b>  | <b>188</b>         | <b>143</b>    |
| <b>TOTAL GROSS FINANCIAL DEBT (A)</b>   | <b>43,313</b>      | <b>52,101</b> |
| <b>FINANCIAL ASSETS</b>   |                    |               |
| <b>Non-current financial assets</b>   |                    |               |
| Securities other than equity investments  | 7                  | 8             |
| Financial receivables and other non-current financial assets  | 386                | 988           |
|   | <b>393</b>         | <b>996</b>    |
| <b>Current financial assets, excluding financial assets relating to discontinued operations/assets held for sale</b>                      |                    |               |
| 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> |
| <b>Financial assets relating to discontinued operations/assets held for sale</b> | <b>84</b>     | <b>37</b>     |
| <b>TOTAL FINANCIAL ASSETS (B)</b>  | <b>10,451</b> | <b>12,243</b> |
| <b>NET FINANCIAL DEBT (A-B)</b>  | <b>32,862</b> | <b>39,858</b> |



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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          |
| <b>Total</b>   | <b>278</b>         | <b>1,263</b> |

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<br>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<br>current portion of long-term debt) | 9,514                                  | 24         | 298                 | 3          | 9,812         | 19         | 4,400         | 10         |
| <b>Total gross financial debt</b>                                | <b>40,305</b>                          | <b>100</b> | <b>11,653</b>       | <b>100</b> | <b>51,958</b> | <b>100</b> | <b>43,125</b> | <b>100</b> |
| <b>Discontinued operations/assets held for sale</b>              |  |            |                     |            | <b>143</b>    |            | <b>188</b>    |            |
| <b>Total</b>   |  |            |                     |            | <b>52,101</b> |            | <b>43,313</b> |            |

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         |
| <b>Total</b>                             | <b>34,350</b>           | <b>1,874</b>    | <b>36,224</b> | <b>29,757</b>           | <b>8,224</b>    | <b>37,981</b> |

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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         |
| <b>Total</b>                       | <b>36,116</b>             | <b>37,219</b> |

At December 31, 2005, convertible and exchangeable notes, were detailed as follows:

| Original  | Nominal<br>repayment<br>amount |        |   |            | Maturity   | Issue | Market  | Market                |
|---|--------------------------------|--------|---|------------|------------|-------|---------|-----------------------|
| Currency  | (millions of Euro)             | Coupon | New shares issuers  | Issue date | date       | price | price   | value                 |
|   |                                |        |   |            |            | (%)   | (%)     | (millions<br>of Euro) |
| <b>Convertible notes issued by Telecom Italia S.p.A.</b>  |                                |        |   |            |            |       |         |                       |
| Euro  | 600                            | 1.50%  | Telecom Italia S.p.A.   | 11/23/2001 | 01/01/2010 | 100   | 124.948 | 633                   |
| <b>Exchangeable notes issued by Telecom Italia Finance S.A. and guaranteed by Telecom Italia S.p.A.</b> |                                |        |   |            |            |       |         |                       |
| Euro  | 2,042                          | 1.00%  | Telecom Italia S.p.A./<br>Telecom Italia Media S.p.A./<br>Seat Pagine Gialle S.p.A. | 03/15/2001 | 03/15/2006 | 100   | 117.205 | 2,033                 |
| <b>Total</b>  | <b>2,642</b>                   |        |   |            |            |       |         | <b>2,666</b>          |

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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) |
|--|---------------------------------------|---|-----------------------|------------|---------------------------|------------------------|------------------|---------------------------------|
| <b>Notes and bonds issued by Telecom Italia S.p.A.</b>   |                                       |   |                       |            |                           |                        |                  |                                 |
| Euro   | 1,000                                 | 1,000   | 3M Euribor + 0.33     | 01/29/2004 | 01/30/2006 <sup>(°)</sup> | 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                             |
| <b>Sub -Total</b>  |                                       | <b>9,798</b>                                  |                       |            |                           |                        |                  | <b>10,203</b>                   |
| <b>Notes and bonds issued by Telecom Italia Finance S.A. and guaranteed by Telecom Italia S.p.A.</b> |                                       |   |                       |            |                           |                        |                  |                                 |
| Euro   | 1,045                                 | 1,045   | 3M Euribor + 1.25     | 05/29/2002 | 01/03/2006                | 99.456 <sup>(*)</sup>  | 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 <sup>(*)</sup> | 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 <sup>(*)</sup>  | 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 <sup>(*)</sup> | 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 <sup>(*)</sup> | 135.863          | 1,427                           |
| CHF  | 88                                    | 56  | 5.625                 | 06/12/1986 | 06/12/2046                | 99.000                 | 109.748          | 61                              |
| <b>Sub -Total</b>  |                                       | <b>16,302</b>                                 |                       |            |                           |                        |                  | <b>17,846</b>                   |
| <b>Notes and bonds issued by Telecom Italia Capital S.A. and guaranteed by Telecom Italia S.p.A.</b> |                                       |   |                       |            |                           |                        |                  |                                 |
| 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                             |

|                   |               |               |
|-------------------|---------------|---------------|
| <b>Sub -Total</b> | <b>8,477</b>  | <b>8,259</b>  |
| <b>Total</b>      | <b>34,577</b> | <b>36,308</b> |

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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At December 31, 2005, Telecom Italia had the following ratings:

|                    | <u>As of December 31, 2005</u> |                |
|--------------------|--------------------------------|----------------|
|                    | <u>Rating</u>                  | <u>Outlook</u> |
| 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:

| <u>S&amp;P's</u>                    |          | <u>Moody's</u>                        |         | <u>Fitch Ratings</u>                |         |
|-------------------------------------|----------|---------------------------------------|---------|-------------------------------------|---------|
| <u>Latest update March 30, 2006</u> |          | <u>Latest update December 7, 2004</u> |         | <u>Latest update April 11, 2006</u> |         |
| 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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**Liquidity And Capital Resources**

- 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        |
| <b>Sub-total</b>                                    | <b>7,339</b>            | <b>3,565</b> | <b>3,091</b> | <b>4,076</b> | <b>5,357</b> | <b>23,981</b> | <b>47,409</b> |
| 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         |
| <b>Total non-current financial debt</b>             | <b>7,573</b>            | <b>3,723</b> | <b>3,234</b> | <b>4,188</b> | <b>5,436</b> | <b>25,383</b> | <b>49,537</b> |
| <b>Current financial liabilities</b>                | <b>760</b>              |              |              |              |              |               | <b>760</b>    |
| <b>Total</b>  | <b>8,333</b>            | <b>3,723</b> | <b>3,234</b> | <b>4,188</b> | <b>5,436</b> | <b>25,383</b> | <b>50,297</b> |
| <b>Discontinued operations/assets held for sale</b> |                         |              |              |              |              |               | <b>142</b>    |
| <b>Total</b>  |                         |              |              |              |              |               | <b>50,439</b> |

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        |
| <b>Sub-total</b>                        | <b>8,745</b>            | <b>3,576</b> | <b>3,084</b> | <b>4,197</b> | <b>5,207</b> | <b>24,188</b> | <b>48,997</b> |
| 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         |
| <b>Total non-current financial debt</b> | <b>8,979</b>            | <b>3,734</b> | <b>3,227</b> | <b>4,309</b> | <b>5,286</b> | <b>25,590</b> | <b>51,125</b> |
| <b>Current financial liabilities</b>    | <b>833</b>              |              |              |              |              |               | <b>833</b>    |
| <b>Total</b>                            | <b>9,812</b>            | <b>3,734</b> | <b>3,227</b> | <b>4,309</b> | <b>5,286</b> | <b>25,590</b> | <b>51,958</b> |

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|   |               |
|---|---------------|
| <b>Discontinued operations/assets held for sale</b> | <b>143</b>    |
| <b>Total</b>  | <b>52,101</b> |

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.

|  | <b>Year ended December 31,</b> |                |
|--|--------------------------------|----------------|
|  | <b>2004(1)(2)</b>              | <b>2005(1)</b> |
|  | <b>(millions of Euro)</b>      |                |
| 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            |
| <b>Total acquisition of tangible assets(6)</b> | <b>3,120</b>                   | <b>3,388</b>   |
| Acquisition of intangible assets(7)            | 1,882                          | 1,785          |
| <b>Total capital expenditures(8)</b>           | <b>5,002</b>                   | <b>5,173</b>   |

(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:

|  | <b>Capital Expenditures</b> |
|--|-----------------------------|
|  | <b>2006-2008</b>            |
|  | <b>(billions of Euro)</b>   |
| 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                        |
| <b>Total Telecom Italia Group Capital Expenditures</b> | <b>13-14</b>                |

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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:

|  | <b>Capital Expenditures<br/>for Operations in<br/>Italy<br/>2006-2008</b> |
|--|---|
| 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%   |
| <b>Total capital expenditures for Operations in Italy (billions of Euro)</b>                                 | <b>10-10.5</b>  |

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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**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

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main banker, allocating resources according to needs. The centralized treasury also gives support in negotiating credit lines and financial operations in general.

The table below sets forth, for the periods indicated, the aggregate nominal amount of total long-term financial liabilities (including current portion and leases payable/long rent and excluding discontinued operations/assets held for sale) payable in each year through 2010 and thereafter.

|                                     | 2006               | 2007         | 2008         | 2009         | 2010         | Thereafter    | As of<br>December 31,<br>2005<br>Total |
|-------------------------------------|--------------------|--------------|--------------|--------------|--------------|---------------|--|
|                                     |                    |              |              |              |              |               |  |
|                                     | (millions of Euro) |              |              |              |              |               |  |
| Fixed Rate financial liabilities    | 5,813              | 3,138        | 1,777        | 3,952        | 3,684        | 14,076        | 32,440                                 |
| Floating Rate financial liabilities | 1,760              | 585          | 1,457        | 236          | 1,752        | 11,307        | 17,097                                 |
| <b>Total</b>                        | <b>7,573</b>       | <b>3,723</b> | <b>3,234</b> | <b>4,188</b> | <b>5,436</b> | <b>25,383</b> | <b>49,537</b>                          |

As of December 31, 2005, the fair value of such outstanding debt amounted to approximately 52,717 million. The financial debt's market value is estimated on the basis of the present value as of December 31, 2005 of the future cash flows.

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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%         |
| <b>Total Fixed Rate Debt</b>                              | <b>24,996</b>                          | <b>21,922</b> | <b>20,217</b> | <b>16,326</b> | <b>12,698</b> | <b>9,923</b>  | <b>7,659</b>  |
| 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%         |
| <b>Total Floating Rate Debt</b>                           | <b>15,074</b>                          | <b>14,583</b> | <b>13,197</b> | <b>13,012</b> | <b>11,283</b> | <b>10,870</b> | <b>5,296</b>  |
| <b>Total Long-Term Debt</b>                               | <b>40,070</b>                          | <b>36,505</b> | <b>33,414</b> | <b>29,338</b> | <b>23,981</b> | <b>20,793</b> | <b>12,955</b> |

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)  |
| <b>Fair Value Hedge Derivatives</b>  |  | <b>7,359</b>    | <b>(62)</b>   |
| 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)   |
| <b>Cash Flow Hedge Derivatives</b>   |  | <b>7,758</b>    | <b>(392)</b>  |
| 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)   |
| <b>Non-Hedge Accounting Derivatives</b>  |  | <b>1,885</b>    | <b>(8)</b>  |
| <b>Total Derivative Instruments on Debt Positions</b>  |  | <b>17,002</b>   | <b>(462)</b>  |
| 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)   |
| <b>Derivative Instruments on Financial Assets and on Short-term Treasury Operations (Non-Hedge Accounting Treatment)</b> |  | <b>614</b>      | <b>(11)</b>   |
| <b>Total Telecom Italia Group Derivatives</b>  |  | <b>17,616</b>   | <b>(473)</b>  |

- **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<br>amount at<br>12/31/2005 | Market value<br>of derivatives at<br>12/31/2005<br>(a) | Market value<br>of underlying<br>debt positions at<br>12/31/2005<br>(b) | Market value<br>of debt<br>including<br>related<br>derivatives at<br>12/31/2005<br>(c)=(b-a) | Market value<br>of<br>derivatives at<br>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)  |
| <b>Total</b>                                  | <b>17,002</b>                       | <b>(*)(462)</b>  | <b>17,153</b>   | <b>17,615</b>  | <b>(*)(1,260)</b>                                  |

(\*) 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)  |      |      |                          |              |                     |              |                |
| <b>EUR Interest Rate Swaps</b>        |                     |      |      |                          |              |                     |              |                |
| <b>Receive variable, pay fixed</b>    |                     |      |      |                          |              |                     |              |                |
| 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) |              |                     |              |                |
| <b>Sub-total</b>                      | <b>1,100</b>        |      |      | <b>610</b>               | <b>3,000</b> | <b>120</b>          | <b>4,830</b> | <b>7</b>       |
| <b>EUR Interest Rate Swaps</b>        |                     |      |      |                          |              |                     |              |                |
| <b>Receive variable, pay variable</b> |                     |      |      |                          |              |                     |              |                |
| Amount                                | 41                  |      |      | 500                      |              |                     | 541          | (6)            |
| Average pay rate                      |                     |      |      |                          |              |                     |              |                |



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|                                    |                                    |           |           |              |                                 |            |              |          |
|------------------------------------|------------------------------------|-----------|-----------|--------------|---------------------------------|------------|--------------|----------|
|                                    | 6M Euribor<br>3 bps                |           |           |              | 6M Euribor arr.<br>+190 bps (3) |            |              |          |
| <i>Average receive rate</i>        | Rendiob,<br>Bot,<br>Rendistato (2) |           |           |              | 6M Euribor +<br>244 bps (4)     |            |              |          |
| <b>Quanto swaps</b>                |                                    |           |           |              |                                 |            |              |          |
| <i>Amount</i>                      |                                    |           |           | 350 (5)      | 350                             | 3M Stibor  | <b>700</b>   | <b>5</b> |
| <i>Average pay rate</i>            |                                    |           |           |              | 3.36% (6)                       |            |              |          |
| <i>Average receive rate</i>        |                                    |           |           |              | 7.00%                           |            |              |          |
| <b>BRL Interest Rate Swaps</b>     |                                    |           |           |              |                                 |            |              |          |
| <b>Receive fixed, pay variable</b> |                                    |           |           |              |                                 |            |              |          |
| <i>Amount</i>                      | 10                                 | 14        | 13        | 11           | 9                               | 12         | <b>69</b>    |          |
| <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%      |              |          |
| <b>Total</b>                       | <b>1,151</b>                       | <b>14</b> | <b>13</b> | <b>1,471</b> | <b>3,009</b>                    | <b>482</b> | <b>6,140</b> | <b>6</b> |

(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%.

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*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<br>Market |
|--|------|----------------------|------------|------|--------------|-------------------------|--------------|-------------------|
| (millions of Euro)   |      |                      |            |      |              |                         |              |                   |
| <b>CCIRS</b>   |      |                      |            |      |              |                         |              |                   |
| <b>Receive fixed USD, pay variable Euro</b>  |      |                      |            |      |              |                         |              |                   |
| <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%                   |              |                   |
| <b>Sub-total</b>   |      |                      | <b>850</b> |      | <b>1,593</b> | <b>2,974</b>            | <b>5,417</b> | <b>25</b>         |
| <b>CCIRS</b>   |      |                      |            |      |              |                         |              |                   |
| <b>Receive fixed USD, pay fixed Euro</b>   |      |                      |            |      |              |                         |              |                   |
| <i>Amount</i>  |      |                      |            |      |              | 2,558                   | 2,558        | (328)             |
| <i>Average pay rate</i>  |      |                      |            |      |              | 5.4%                    |              |                   |
| <i>Average receive rate</i>  |      |                      |            |      |              | 5.6%                    |              |                   |
| <b>CCIRS</b>   |      |                      |            |      |              |                         |              |                   |
| <b>Receive dual currency (fixed USD rate,<br/>JPY principal at maturity), pay fixed Euro</b> |      |                      |            |      |              |                         |              |                   |
| <i>Amount</i>  |      |                      |            |      |              | 174                     | 174          | (70)              |
| <i>Average pay rate</i>  |      |                      |            |      |              | 6.94%                   |              |                   |
| <i>Average receive rate</i>  |      |                      |            |      |              | 5.0%                    |              |                   |
| <b>CCIRS</b>   |      |                      |            |      |              |                         |              |                   |
| <b>Receive fixed Yen, pay variable Euro</b>  |      |                      |            |      |              |                         |              |                   |
| <i>Amount</i>  |      |                      |            |      |              | 171                     | 171          | (65)              |
| <i>Average pay rate</i>  |      |                      |            |      |              | 6M Euribor<br>+ 274 bps |              |                   |
| <i>Average receive rate</i>  |      |                      |            |      |              | 3.55%                   |              |                   |
| <b>CCIRS</b>   |      |                      |            |      |              |                         |              |                   |
| <b>Receive variable USD, pay variable Euro</b>   |      |                      |            |      |              |                         |              |                   |
| <i>Amount</i>  |      | 150                  |            |      |              | 332                     | 482          | 9                 |
| <i>Average pay rate</i>  |      | 3M Euribor<br>-4 bps |            |      |              | 6M Euribor<br>+ 56 bps  |              |                   |
| <i>Average receive rate</i>  |      | 3M USD<br>Libor      |            |      |              | 3M USD<br>Libor         |              |                   |

-7 bps

+ 48 bps

**Table of Contents****Item 5. Operating And Financial Review And Prospects****Quantitative And Qualitative Disclosures About Market Risks**

| Foreign Exchange Derivatives                | Maturities                             |  |            |      |              |              |               | Mark to<br>Market |
|---|--|--|------------|------|--------------|--------------|---------------|-------------------|
|   | 2006                                   | 2007                                   | 2008       | 2009 | 2010         | Thereafter   | Total         |                   |
| (millions of Euro)                          |  |  |            |      |              |              |               |                   |
| <b>CCIRS</b>                                |  |  |            |      |              |              |               |                   |
| <b>Receive fixed GBP, pay variable Euro</b> |  |  |            |      |              |              |               |                   |
| <i>Amount</i>                               |  | 685                                    |            |      |              |              | 685           |                   |
| <i>Average pay rate</i>                     |  | 6M Euribor<br>+67 bps                  |            |      |              |              |               |                   |
| <i>Average receive rate</i>                 |  | 6.375%                                 |            |      |              |              |               |                   |
| <i>Amount</i>                               |  | 604                                    |            |      |              |              | 604           |                   |
| <i>Average pay rate</i>                     |  | 3M Euribor<br>+73 bps                  |            |      |              |              |               |                   |
| <i>Average receive rate</i>                 |  | 6.375%                                 |            |      |              |              |               |                   |
| <b>Sub-total</b>                            |  | <b>1,289</b>                           |            |      |              |              | <b>1,289</b>  | <b>(31)</b>       |
| <b>CCIRS</b>                                |  |  |            |      |              |              |               |                   |
| <b>Receive fixed GBP, pay fixed Euro</b>    |  |  |            |      |              |              |               |                   |
| <i>Amount</i>                               |  |  |            |      |              | 751          | 751           | (7)               |
| <i>Average pay rate</i>                     |  |  |            |      |              | 4.34%        |               |                   |
| <i>Average receive rate</i>                 |  |  |            |      |              | 5.625%       |               |                   |
| <b>CCIRS</b>                                |  |  |            |      |              |              |               |                   |
| <b>Receive fixed USD, pay variable BRL</b>  |  |  |            |      |              |              |               |                   |
| <i>Amount</i>                               | 12                                     | 8                                      |            |      |              |              | 20            | (1)               |
| <i>Average pay rate</i>                     | CDI (1)                                | CDI (1)                                |            |      |              |              |               |                   |
| <i>Average receive rate</i>                 | Exchange rate<br>variation<br>+ spread | Exchange rate<br>variation<br>+ spread |            |      |              |              |               |                   |
| <b>Total</b>                                | <b>12</b>                              | <b>1,447</b>                           | <b>850</b> |      | <b>1,593</b> | <b>6,960</b> | <b>10,862</b> | <b>(468)</b>      |

(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<br>notional<br>amount |
|-------------|----------------------------------|
|-------------|----------------------------------|

|   | (millions<br>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                   |
| <b>Total</b>  | <b>614</b>            |

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.

**Table of Contents****Item 6. Directors, Senior Management and Employees****Directors****Item 6. DIRECTORS, SENIOR MANAGEMENT AND EMPLOYEES****6.1 DIRECTORS**

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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**Item 6. Directors, Senior Management and Employees**

**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 Beauteé 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 Columbia 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:

| <b>Name</b>                 | <b>Age</b> | <b>Position</b>  | <b>Appointed</b> |
|-----------------------------|------------|--|------------------|
| Marco Tronchetti Provera    | 58         | Executive Chairman   | 2001             |
| Carlo Orazio Buora          | 60         | Managing Director  | 2001             |
| Riccardo Ruggiero           | 45         | Managing Director of Operations<br>General Manager of Telecom Italia                       | 2005<br>2002     |
| Giuseppe Sala               | 48         | General Manager of Telecom Italia<br>Head of Top Client and Customer Service of Operations | 2003<br>2005     |
| <b>Central Functions:</b>   |            |  |                  |
| 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<br>Head of Corporate and Legal Affairs                                     | 2002<br>2005     |
| Germanio Spreafico          | 53         | Head of Purchasing   | 2001             |
| <b>Operation Functions:</b> |            |  |                  |
| Stefano Pileri              | 50         | Chief Technology Officer<br>Head of Technology   | 2005<br>2005     |
| Luca Luciani                | 38         | Head of Sales  | 2005             |
| Massimo Castelli            | 46         | Chief Marketing Officer<br>Head of Market Development                                      | 2005<br>2005     |
| <b>Business Units:</b>      |            |  |                  |
| Enrico Parazzini            | 62         | Head of Media Business Unit<br>Managing Director of Telecom Italia Media                   | 2003<br>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

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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**Item 6. Directors, Senior Management and Employees**

**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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**Item 6. Directors, Senior Management and Employees**

**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         |
| <b>Consolidated Total</b> | <b>82,620</b>       | <b>85,484</b> |

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<br>December 31,<br>2004(*) | Changes during the year |                          |  |  |                  | Employees at<br>December 31,<br>2005(*) |
|---|-------------------------|--------------------------|--|--|------------------|---|
|   | Hired                   | Terminated<br>employment | Increase of<br>temporary<br>employment | Change in<br>scope of<br>consolidation | Total<br>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:

|                                   | <b>Executives</b> | <b>Middle<br/>Management</b> | <b>White<br/>collars</b> | <b>Blue<br/>collars</b> | <b>Temporary<br/>employees</b> | <b>Total</b>  |
|-----------------------------------|-------------------|------------------------------|--------------------------|-------------------------|--------------------------------|---------------|
| 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                          | 9,475                    | 6                       | 681                            | 10,604        |
| Australia, Africa and Asia        | 3                 | 12                           | 8                        |                         |                                | 23            |
| <b>Telecom Italia Group Total</b> | <b>1,476</b>      | <b>4,889</b>                 | <b>75,068</b>            | <b>669</b>              | <b>3,382</b>                   | <b>85,484</b> |

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**Item 6. Directors, Senior Management and Employees**

**Employees**

Telecom Italia Group employees in Italy are represented by two categories of national unions, one for managerial staff and another for non-managerial staff. Employment agreements in Italy are generally collectively negotiated at the national level between the national employers' associations and the workers' unions and, for medium and large companies, also at company level. Renewals of collective agreements are subject to general guidelines agreed upon between the Italian Government, the employers' associations and trade unions. These guidelines establish that salary increases negotiated at the national level should not exceed agreed upon inflation rates. Individual companies may enter into additional contracts in order to link collective bonuses to the company's productivity or profitability.

Approximately 2% of the Group's employees held executive positions on December 31, 2005.

Employment contracts for managerial staff are governed by a national collective agreement that expired in December 2003 and was renewed in November 2004. This new agreement applies through 2008.

The national collective agreement for non-managerial staff expired in December 2004.

In December 2005, after nearly a year of negotiations, a draft agreement has been signed between ASSTEL (Assotelecomunicazioni) and Trade Unions on renewal of the National Collective Labour Agreement for telecommunication service businesses. The regulation section of CCNL relative to TLC, effective up to December 31, 2008, has been adapted to the most significant new concepts introduced by Legislative Decree No. 276/03 concerning the labour market, and those introduced by specific legislation on working hours; the economic section of the agreement, on the contrary, will be effective up to December 31, 2006.

In May 2005, an agreement was signed with Trade Unions to redefine the entire corporate participatory and representative system. The principle of the participatory model has been confirmed as the tool to reconcile objectives aimed at safeguarding workers as well as the company's competitiveness.

In November 7, 2005, after a few months of negotiation, an agreement was reached with Trade Unions on the development and reorganization plan for the three-year period of 2005-2007. The agreement signed by the parties is based on the industrial project for the integration of the fixed and mobile telephony businesses.

The agreement with Trade Unions also identifies certain tools aimed at ensuring the correct occupational dimension and the necessary professional remix, such as the targeted introduction of new resources, the professional and intercompany mobility and the collective reduction of employees.

During 2005, the Telecom Italia Group performed activities relating to Internal Communication (e.g. magazine, newsletters, and a new Intranet Portal), Employee Satisfaction (the participation to the people satisfaction survey in the first quarter of the 2006 was of 73% of Telecom Italia Group in the world; the satisfaction rate was in Italy of 6.21 on a 1 to 10 range base) and Training (2

million hours for the Italian Personnel).

Assilt, the health care fund for Telecom Italia Group employees, reimburses the medical expenses of 215,000 people, of which 68,000 retired people and their families.

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**Item 6. Directors, Senior Management and Employees Compensation Of Directors, Officers And Members Of The Board Of Auditors**

**6.6 COMPENSATION OF DIRECTORS, OFFICERS AND MEMBERS OF THE BOARD OF AUDITORS**

**6.6.1 COMPENSATION OF DIRECTORS**

The total annual remuneration of the Board of Directors was established by the Company's General Shareholders Meeting of May 6, 2004, pursuant to article 2389, paragraph 1, of the Italian Civil Code, in the amount of 2,700,000 (amount to be divided amongst the directors in accordance with the resolutions on the matter that the Board itself would have adopted).

The General Shareholders Meeting held on April 7, 2005, increased (exclusively for the second and third year of the Board's mandate) the maximum total annual gross amount of the directors' remuneration to 3,000,000, taking into account the increased size of the Board of Directors (from 19 to 21 members).

The total compensation paid by Telecom Italia and by the Telecom Italia Group subsidiaries in 2005 to the members of the Board of Directors of Telecom Italia was 29,785,000.

Such overall amount is presently distributed as follows:

- 114,000 to each director in office;
- an additional 63,000 to each of the members of the Internal Control and Corporate Governance Committee;
- an additional 52,000 to each of the members of the Remuneration Committee;
- an additional 20,000 to be paid to each of the members of the Strategy Committee other than the Chairman of the Board and the Managing Director Carlo Orazio Buora; and
- an additional 20,000 to be paid to the director appointed to the Supervisory Panel set up under Legislative Decree No. 231/2001 (see Item 10. Additional Information 10.1 Corporate Governance 10.1.2 General Board of Directors Internal Control System ).

The following table lists the Directors who served during 2005 and their respective compensation as of December 31, 2005. The compensation relates only to the period of 2005 in which they served as set forth below:

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| <u>Name</u>                 | <u>Position</u>                       | <u>Period</u>  | <u>Compensation<br/>base</u> | <u>Bonus</u> | <u>Non cash<br/>benefit</u> | <u>Other<br/>Compensation</u> |
|-----------------------------|---------------------------------------|----------------|------------------------------|--------------|-----------------------------|-------------------------------|
| (thousand of Euro)          |                                       |                |                              |              |                             |                               |
| Marco TRONCHETTI<br>PROVERA | Chairman of the<br>Board of Directors | 1/1-12/31/2005 | 2,314(1)                     |              | 2,900(2)                    |                               |
| Gilberto BENETTON           | Deputy Chairman                       | 1/1-12/31/2005 | 114                          |              |                             |                               |
| Carlo Orazio BUORA          | Managing Director                     | 1/1-12/31/2005 | 2,077(1)                     |              | 2,250(3)                    | 80(4)                         |
| Marco DE BENEDETTI(*)       | Managing Director                     | 4/7-10/05/2005 | 94(1)(5)                     |              | 2,856(6)                    | 8,597(7)                      |
| Riccardo RUGGIERO           | Managing Director<br>General Manager  | 1/1-12/31/2005 | 554(1)(8)                    | 5(9)         | 4,527(10)                   | 982(11)                       |
| Paolo BARATTA               | Director                              | 1/1-12/31/2005 | 166(12)                      |              |                             |                               |
| John Robert Sotheby BOAS    | Director                              | 1/1-12/31/2005 | 114                          |              |                             |                               |
| Giovanni CONSORTE           | Director                              | 1/1-12/31/2005 | 114                          |              |                             |                               |
| Francesco DENOZZA           | Director                              | 1/1-12/31/2005 | 177(13)                      |              |                             |                               |
| Domenico DE SOLE            | Director                              | 1/1-12/31/2005 | 197(14)                      |              |                             |                               |
| Luigi FAUSTI                | Director                              | 1/1-12/31/2005 | 166(12)                      |              |                             |                               |
| Guido FERRARINI             | Director                              | 1/1-12/31/2005 | 197(15)                      |              |                             |                               |
| Jean Paul FITOUSSI          | Director                              | 1/1-12/31/2005 | 114                          |              |                             |                               |
| Enzo GRILLI                 | Director                              | 4/7-12/31/2005 | 85                           |              |                             | 57(16)                        |
| Gianni MION                 | Director                              | 1/1-12/31/2005 | 114(17)                      |              |                             | 95(17)(18)                    |
| Massimo MORATTI             | Director                              | 1/1-12/31/2005 | 114                          |              |                             |                               |
| Marco ONADO                 | Director                              | 1/1-12/31/2005 | 197(14)                      |              |                             |                               |
| Renato PAGLIARO             | Director                              | 1/1-12/31/2005 | 114(19)                      |              |                             |                               |
| Pasquale PISTORIO           | Director                              | 1/1-12/31/2005 | 186(20)                      |              |                             |                               |
| Carlo A. PURI NEGRI         | Director                              | 1/1-12/31/2005 | 114                          |              |                             |                               |
| Luigi ROTH                  | Director                              | 1/1-12/31/2005 | 114                          |              |                             |                               |

(\*) Resigned as a director on October 5, 2005.

(1) The amount includes the remuneration ex art. 2389, paragraph 3, of the Italian Civil Code.

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**Item 6. Directors, Senior Management and Employees Compensation Of Directors, Officers And Members Of The Board Of Auditors**

- (2) This refers to variable remuneration ex art. 2389 paragraph 3 of the Italian Civil Code for the year 2004, paid in 2005 since it was subject to reaching a consolidated operating income 2004 budget target, with a positive EVA change, and an extraordinary bonus voted by the Telecom Italia S.p.A. Board of Directors meeting of April 7, 2005. With regard to 2005, the Board of Directors has anticipated additional remuneration of euro 1,400,000.00 (unchanged compared to 2004) the payment of which, in 2006, is subject to reaching a consolidated operating income 2005 budget target, with a positive EVA change.
- (3) This refers to variable remuneration ex art. 2389 paragraph 3 of the Italian Civil Code for the year 2004, paid in 2005 since it was subject to reaching a consolidated operating income 2004 budget target, with a positive EVA change, and an extraordinary bonus voted by the Telecom Italia S.p.A. Board of Directors meeting of April 7, 2005. With regard to 2005, the Board of Directors has anticipated additional remuneration of euro 1,250,000.00 (unchanged compared to 2004) the payment of which, in 2006, is subject to reaching a consolidated EBIT 2005 budget target, with a positive EVA change.
- (4) Remuneration for the post of Chairman of Telecom Italia Mobile S.p.A. for the period January 1 to June 30, 2005 and for the post of Chairman of Tim Italia S.p.A., not received but paid over to Telecom Italia S.p.A..
- (5) The amount relating to remuneration ex art. 2389, section 1, of the Italian Civil Code was paid to Telecom Italia S.p.A..
- (6) The amount includes remuneration paid in respect of Management By Objectives (MBO) and Long-Term Incentives (LTI).
- (7) The amount includes remuneration paid upon termination of the employment relationship with Telecom Italia and with Tim Italia, the amount relating to gross remuneration as an employee, comprised of a lump-sum payment of the variable compensation relating to the year 2005, amounts relating to remuneration ex art. 2389 paragraphs 1 and 3 of the Italian Civil Code received in Telecom Italia Mobile S.p.A. and in Tim Italia S.p.A., extraordinary remuneration ex art. 2389 paragraph 3 of the Italian Civil Code as the CEO of Telecom Italia Mobile S.p.A., and the remuneration received as a member of the Supervisory Panel under Law No. 231/2001 of Progetto Italia S.p.A.. The amounts ex art. 2389 paragraph 1 of the Italian Civil Code are paid over to Telecom Italia S.p.A..
- (8) The amount relating to remuneration ex art. 2389, section 1, of the Italian Civil Code is not paid to the individual.
- (9) The amount includes the conventional amount of accident insurance.
- (10) The amount includes the remuneration paid in respect of Management By Objectives (MBO) and Long-Term Incentives (LTI), the retention payment plan installment and remuneration consisting of the extraordinary bonus ex art. 2389 paragraph 3 of the Italian Civil Code.
- (11) The amount includes gross employment income and the compensation ex art. 2389 paragraph 1 of the Italian Civil Code for the post of CEO held in Tim Italia S.p.A. during the period October 5 to December 31, 2005 paid over to Telecom Italia.
- (12) The amount includes the remuneration paid as a member of the Remuneration Committee.
- (13) The amount includes the remuneration paid as a member of the Committee for Internal Control and Corporate Governance.
- (14) The amount includes the remuneration paid as a member of the Committee for Internal Control and Corporate Governance and the Strategies Committee.
- (15)

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The amount includes the compensation paid as a member of the Committee for Internal Control and Corporate Governance and a member of the Supervisory Panel under Legislative Decree No. 231/2001.

(16) The amount includes remuneration as a Director and member of the Remuneration Committee in Telecom Italia Mobile S.p.A. (January 1 to June 30, 2005) and as a Director in Tim Italia S.p.A. (January 1 to April 7, 2005).

(17) Remuneration not received but paid over to Edizione Holding.

(18) The amount includes the remuneration paid for the post of Deputy Chairman in Telecom Italia Mobile (January 1 to June 30, 2005), Deputy Chairman in Tim Italia S.p.A. (January 1 to December 31, 2005) and Director in Telecom Italia Media S.p.A. (January 1 to April 3, 2005).

(19) Remuneration not received but paid over to Mediobanca.

(20) The amount includes the remuneration received as a member of the Remuneration Committee and the Strategies Committee.

The compensation received by Mr. Buora, Mr. Mion, Mr. De Benedetti and Mr. Grilli, in their capacity as directors of TIM S.p.A. in 2005, up to the merger of the company with and into Telecom Italia is presented in the preceding table under other remuneration, since they are directors of the parent Telecom Italia S.p.A..

**Table of Contents****Item 6. Directors, Senior Management and Employees Compensation Of Directors, Officers And Members Of The Board Of Auditors**

The following tables list the stock options held by Mr. Ruggiero and Mr. De Benedetti. Applicable Italian law requires disclosure of individual compensation in the form of stock options for members of the Board of Directors and for General Managers. The compensation in the form of stock options for Mr. Ruggiero and Mr. De Benedetti was disclosed pursuant to legislative Decree No. 58/98 in the Telecom Italia Group's home jurisdiction Annual Report for the year ended December 31, 2005. See also below 6.7 Options to Purchase Securities from Registrant .

| Name     | Post held | Options held at the beginning of 2005 |                            |                         | Options granted during 2005 |                        |                         | Options exercised during 2005 |                        |                   | Options expired in 2005 | Options held at the end of 2005 |                             |                         |
|----------|-----------|---------------------------------------|----------------------------|-------------------------|-----------------------------|------------------------|-------------------------|-------------------------------|------------------------|-------------------|-------------------------|---------------------------------|-----------------------------|-------------------------|
|          |           | Number of options(*)                  | Average exercise price(**) | Average expiration date | Number of options           | Average exercise price | Average expiration date | Number of options             | Average exercise price | price during year | Number of options       | Number of options(*)            | Average exercise price (**) | Average expiration date |
| (A)      | (B)       | (1)                                   | (2)                        | (3)                     | (4)                         | (5)                    | (6)                     | (7)                           | (8)                    | (9)               | (10)                    | (11)=<br>1+4-7-10               | (12)                        | (13)                    |
| Riccardo |           |                                       |                            |                         |                             |                        |                         |                               |                        |                   |                         |                                 |                             |                         |
|          | M.D./     |                                       |                            |                         |                             |                        |                         |                               |                        |                   |                         |                                 |                             |                         |
| Ruggiero | G.M.      | 750,000                               | 3.177343                   | 2007                    |                             |                        |                         |                               |                        |                   |                         | 750,000                         | 3.177343                    | 2007                    |
|          |           | 200,000                               | 2.788052                   | 2010                    |                             |                        |                         |                               |                        |                   |                         | 200,000                         | 2.788052                    | 2010                    |

(\*) Each option allows the subscription of 3.300871 Telecom Italia Ordinary Shares.

(\*\*) The average exercise price is the subscription price of Telecom Italia Ordinary Shares deriving from the exercise of options.

| Name | Post held | Options held at the beginning of 2005 |                            |                         | Options granted during 2005 |                        |                         | Options exercised during 2005 |                        |                   | Options expired in 2005 | Options held at the end of 2005 |                        |                         |
|------|-----------|---------------------------------------|----------------------------|-------------------------|-----------------------------|------------------------|-------------------------|-------------------------------|------------------------|-------------------|-------------------------|---------------------------------|------------------------|-------------------------|
|      |           | Number of options                     | Average exercise price(**) | Average expiration date | Number of options           | Average exercise price | Average expiration date | Number of options             | Average exercise price | price during year | Number of options       | Number of options(*)            | Average exercise price | Average expiration date |
| (A)  | (B)       | (1)                                   | (2)                        | (3)                     | (4)                         | (5)                    | (6)                     | (7)                           | (8)                    | (9)               | (10)                    | (11)=<br>1+4-7-10               | (12)                   | (13)                    |
|      |           |                                       |                            |                         |                             |                        |                         |                               |                        |                   |                         |                                 |                        |                         |



| (A)       | (B)  | (1)       | (2)      | (3)  | (4) | (5) | (6) | (7) | (8) | (9) | (10) | (11)=<br>1+4-7-10 | (12)     | (13) |
|-----------|------|-----------|----------|------|-----|-----|-----|-----|-----|-----|------|-------------------|----------|------|
| Marco De  |      |           |          |      |     |     |     |     |     |     |      |                   |          |      |
| Benedetti | G.M. | 566,667   | 3.710983 | 2008 |     |     |     |     |     |     |      | 566,667           | 3.710983 | 2008 |
|           |      | 1,000,000 | 3.277457 | 2008 |     |     |     |     |     |     |      | 1,000,000         | 3.277457 | 2008 |

(\*) Each option allows the subscription of 1.73 Telecom Italia Ordinary Shares.

(\*\*) The average exercise price is the subscription price of Telecom Italia Ordinary Shares deriving from the exercise of options

Following the merger of TIM with and into Telecom Italia, each original TIM option entitles the holder to subscribe to 1.73 Ordinary Shares; the subscription price of the shares has been modified dividing the original exercise price by the assignment ratio (1.73). The value of the average exercise price indicated in the table is the subscription price of the shares.

### 6.6.2 COMPENSATION OF EXECUTIVE OFFICERS

The total compensation paid by the Company or by any of the Company's subsidiaries in 2005 to the Company's executive officers was 31,978,728.

The contracts with executive officers of Central Functions and General Manager Giuseppe Sala contain the following clauses:

- if the Company terminates the work relationship (with the exception of a termination for good cause) and the executive officer waives certain rights to which he is entitled pursuant to applicable Italian law, the Company will pay to the executive officer a separation allowance in the amount of two to four years of salary plus, in certain cases, a lump sum corresponding to the average bonus compensation received in the three years (or shorter period) preceding his termination; and
- if the executive officer terminates the work relationship for good cause due to a reduction in responsibilities and tasks assigned to the executive officer, then such executive officer will be entitled to an amount corresponding to 50% of the amount described above.

### 6.6.3 COMPENSATION OF MEMBERS OF THE BOARD OF AUDITORS

The annual compensation attributed to the Board of Auditors in office during 2005 was established by Olivetti's General Shareholders' Meeting of May 26, 2003 at 116,000 for each Auditor and 155,000 for the Chairman; such amounts were revised by Telecom Italia's General Shareholders' Meeting of May 6, 2004 and increased, respectively, to 128,000 for each Auditor and 171,000 for the Chairman of the Board.

The total compensation paid by the Company or by any of the Telecom Italia Group subsidiaries in 2005 to the members of the Board of Auditors was 881,000.

**Table of Contents****Item 6. Directors, Senior Management and Employees Compensation Of Directors, Officers And Members Of The Board Of Auditors**

The following table sets forth the members of the Board of Auditors in office during 2005 and the compensation received by the Board of Auditors for services rendered during the year ended December 31, 2005:

| <u>Name</u>              | <u>Position</u> | <u>Period</u>  | <u>Compensation<br/>base</u> | <u>Bonus</u> | <u>Non<br/>cash<br/>benefit</u> | <u>Other<br/>compensation</u> |
|--------------------------|-----------------|----------------|------------------------------|--------------|---------------------------------|-------------------------------|
| (thousand of Euro)       |                 |                |                              |              |                                 |                               |
| Ferdinando SUPERTI FURGA | Chairman        | 1/1 12/31/2005 | 191(1)                       |              |                                 |                               |
| Rosalba CASIRAGHI        | Acting Auditor  | 1/1 12/31/2005 | 128                          |              |                                 |                               |
| Paolo GOLIA              | Acting Auditor  | 1/1 12/31/2005 | 128                          |              |                                 |                               |
| Salvatore SPINIELLO      | Acting Auditor  | 1/1 12/31/2005 | 128                          |              |                                 | 32(2)                         |
| Gianfranco ZANDA         | Acting Auditor  | 1/1 12/31/2005 | 128                          |              |                                 | 146(3)                        |

(1) The amount includes the remuneration paid as member of the Supervisory Panel (Legislative Decree No. 231/2001).

(2) Remuneration for the office of Acting Statutory Auditor in Telecom Italia Media S.p.A..

(3) Remuneration for the office of Chairman of the Board of Statutory Auditors in the subsidiary IT Telecom S.p.A. and Acting Auditor in the subsidiaries Finsiel S.p.A. (for the period 1/1-6/28/2005), Telecom Italia Mobile S.p.A. (for the period 1/1-6/30/2005) and Tim Italia S.p.A..

The compensation received by Mr. Zanda, in his capacity as auditor of TIM S.p.A. in 2005, up to the merger of the company with and into Telecom Italia, was 37,192.

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**Item 6. Directors, Senior Management and Employees**

**Options To Purchase Securities From Registrant**

**6.7 OPTIONS TO PURCHASE SECURITIES FROM REGISTRANT**

Some listed companies of the Group have awarded forms of stock incentives to their employees (managers and middle management) using stock options plans.

At the end of 2005, the existing stock options plans relate to options which give the right to the subscription of Telecom Italia Ordinary Shares (including the options at one time granted to TIM S.p.A.) and Telecom Italia Media ordinary shares.

For further details, please see Note 39 Other Information of the Notes to the Consolidated Financial Statements.

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Item 7. Major Shareholders And Related-Party Transactions

Major Shareholders

**Item 7. MAJOR SHAREHOLDERS AND RELATED-PARTY TRANSACTIONS****7.1 MAJOR SHAREHOLDERS****7.1.1 THE OLIMPIA SHAREHOLDERS AGREEMENTS**

The information contained herein regarding the Olimpia shareholders' agreements has been derived from publicly available information filed by the parties involved with regulatory authorities. So far as Telecom Italia is aware, no facts have been omitted herein which would render the information misleading. No further or other responsibility in respect of such information is accepted by Telecom Italia.

Several shareholders' agreements exist among Olimpia's shareholders.

In particular, shareholders' agreements were entered into between Pirelli S.p.A. (now Pirelli and C. S.p.A.) and Edizione Holding S.p.A. (whose obligations and rights were subsequently assigned to Edizione Finance International S.A.) on August 7, 2001, as amended on September 14, 2001 and February 13, 2002 (hereinafter the "Agreements"). Shareholders' agreements were also entered into among Pirelli, IntesaBCI S.p.A. (now Banca Intesa S.p.A.) and UniCredit on September 14, 2001 and subsequently amended on September 26, 2001, October 24, 2001 and December 16, 2003 (hereinafter "Agreements with the Banks"). In addition, following the execution of a term sheet on December 16, 2002, shareholders' agreements were entered into among Pirelli, Edizione, Unicredit and Intesa (collectively, the "Former Olimpia Shareholders"), Olimpia and Hopa on February 21, 2003, as amended on January 23, 2004 and January 28, 2005 (hereinafter the "Agreements with Hopa").

The Agreements have a duration of three years and can be renewed at each expiration date.

The Agreements with the Banks have a duration of three years and can be renewed at each expiration date. The renewal period is two years. On April 24, 2004, a notice was published stating that the Agreements with the Banks were renewed until October 4, 2006. With letters dated respectively March 27 and March 28, 2006, Intesa and Unicredit notified Pirelli of their withdrawal, effective as from October, 2006 and the exercise of their right to sell Pirelli their entire holdings in Olimpia for a consideration of approximately 585 million each, in line with the carrying value.

The Agreements with Hopa had a three-year term as from May 9, 2003, subject to extension by mutual agreement of the parties. With letter dated February 6, 2006, Pirelli, Edizione Holding S.p.A., Edizione Finance International S.A., Unicredit, Intesa and Olimpia notified Hopa of their withdrawal, effective as from May, 2006; as a result, the Agreements with Hopa have been terminated. According to the Agreements with Hopa there are now a number of possible outcomes: the partial demerger of Olimpia takes place and Olimpia may cause the partial demerger of Holinvest; in the event of any such partial demerger transactions, Hopa would receive its proportional share of Olimpia's assets and liabilities (determined in accordance with the Agreements with Hopa) and Olimpia would receive its proportional share of Holinvest's assets and liabilities (determined in accordance with the Agreements

with Hopa); in addition Hopa would receive a premium in the lump sum of 208,000,000. However, in addition to the foregoing, within fifteen business days from the termination of the Agreements with Hopa, instead of the demerger of Olimpia, the Former Olimpia Shareholders may choose to liquidate Hopa (and therefore buy the pro-quota of Hopa's entire holding in Olimpia) with a payment in cash at market prices; correspondingly, instead of the demerger of Holinvest, Hopa may liquidate Olimpia (and therefore buy Olimpia's holding in Holinvest) with a payment in cash at market prices. As of the date of this Annual Report, the Former Olimpia Shareholders and Hopa have not yet determined which option under the Agreements with Hopa will be pursued.

The Agreements and the Agreements with the Banks deal with the nomination of the Board of Directors of Olimpia, Olivetti, Old Telecom Italia (now Telecom Italia, as the company resulting from the Merger) and SEAT (now Telecom Italia Media) and identify certain issues on which the board resolutions of such companies have to be taken in accordance with the provisions of the Agreements and the Agreements with the Banks. The Agreements and the Agreements with the Banks also discuss the rules for the resolution of disagreements among the contracting parties on key issues (so-called deadlock situations). In addition, the Agreements and the Agreements with the Banks govern the consequences among the parties of any change in the structure of control of Pirelli (in the Agreements with the Banks) and of Edizione or of Pirelli (in the Agreements); and grant the parties the right to purchase or sell Olimpia shares in the event of a withdrawal of a party from the agreements.

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**Item 7. Major Shareholders And Related-Party Transactions**

**Major Shareholders**

The provisions relating to the nomination of the members of the Boards of Directors of Olivetti, Old Telecom Italia and Telecom Italia Media are set forth below. In connection with the composition of the Boards of Directors of such companies, the parties to the Shareholders' Agreements have agreed to use their best efforts, within the limits established by law, in order to cause:

- the nomination by Edizione of one-fifth of the Boards of Directors, without taking into account the directors whose designation is reserved by law or applicable bylaws to the market or other parties;
- the nomination of one director by Intesa;
- the nomination of one director by Unicredit;
- the nomination of the vice-president of the Boards of Directors from among the directors nominated by Edizione; and
- in the event of the establishment of an Executive Committee, the election of one member of the Executive Committee from among the directors nominated by Edizione. See Item 6. Directors, Senior Management and Employees 6.1 Directors .

The nomination rights of Banca Intesa S.p.A. and UniCredito Italiano S.p.A. will fall away after their withdrawal becomes effective.

Telecom Italia is not subject to direction and coordination pursuant to Article No. 2497 et seq. of the Italian Civil Code nor to the control of any person pursuant to Article No. 93 of the Consolidated Law. Olympia is the largest shareholder in Telecom Italia, with a stake equal to, as of May 10, 2006, approximately 18%. Under the *voto di lista* system for the election of directors, a shareholder or group of shareholders owning 1% or more of the shares may put forward a slate of directors for election to the Board. As a result of this system 15 of the directors elected at the shareholders' meeting of May 6, 2004 were candidates put forward by Olympia. The *voto di lista* system did not apply in the Shareholders' Meeting held on April 7, 2005, that increased the number of directors from 19 to 21, and to the Shareholders' Meetings held on April 13, 2006, that replaced two directors who had resigned in the meantime. See Item 10. Additional Information 10.1 Corporate Governance 10.1.2 General Board of Directors Appointment .

There are no arrangements known to the Company the operation of which may result in any shareholder obtaining a controlling interest in Telecom Italia.

**Table of Contents****Item 7. Major Shareholders And Related-Party Transactions****Major Shareholders****7.1.2 SHAREHOLDERS OWNERSHIP****V BOARD OF DIRECTORS**

The following table shows the ownership of Telecom Italia and Telecom Italia Media shares, as of May 10, 2006, by the Directors of Telecom Italia who were in office during 2005 (as well as of the directors appointed by the General Meeting of April 13, 2006).

| Name                        | Company               | Class of shares | Number of       | Number of | Number of | Number of          |
|-----------------------------|-----------------------|-----------------|-----------------|-----------|-----------|--------------------|
|                             |                       |                 | shares          |           |           | shares             |
|                             |                       |                 | held at         | shares    | shares    | held as of         |
|                             |                       |                 | the end of      |           |           | May 10,            |
|                             |                       |                 | 2004            |           |           | 2006               |
|                             |                       |                 | (or at the date | shares    | shares    | (or as of the date |
|                             |                       |                 | of appointment) | purchased | sold      | on which           |
|                             |                       |                 |                 |           |           | individual left    |
|                             |                       |                 |                 |           |           | post, if before)   |
| Marco TRONCHETTI<br>PROVERA | Telecom Italia        | Ordinary        |                 | 2,000,000 |           | 2,000,000          |
|                             | Telecom Italia        | Savings         |                 | 1,000,000 |           | 1,000,000          |
| Gilberto BENETTON           | Telecom Italia Mobile | Ordinary        | 1,125,000       |           |           | 1,946,250(1)       |
|                             | Telecom Italia        | Savings         |                 | 990,000   |           | 990,000            |
| Diana BRACCO                | Telecom Italia        | Savings         |                 |           |           | 29,805             |
|                             | Telecom Italia Media  | Ordinary        |                 |           |           | 594                |
| Luigi FAUSTI                | Telecom Italia Mobile | Ordinary        | 50,000          |           | 46,540(2) | 5,985(3)           |
| Guido FERRARINI             | Telecom Italia        | Ordinary        |                 | 50,000    |           | 50,000             |
| Gianni MION                 | Telecom Italia        | Savings         |                 |           |           |                    |
|                             | Telecom Italia        | Ordinary        | 15,000(4)       | 8,200     |           | 23,200             |
|                             | Telecom Italia Mobile | Ordinary        |                 | 20,945(4) |           | 20,945             |
|                             |                       |                 | 3,500(4)        |           |           | 6,055(5)           |
|                             | Telecom Italia Mobile | Savings         | 5,000(4)        |           |           | 11,800(6)          |
| Marco ONADO                 | Telecom Italia Mobile | Savings         |                 |           |           |                    |
|                             |                       |                 | 4,700           |           |           | 11,092(7)          |
|                             | Telecom Italia        | Ordinary        |                 | 30,031    |           | 30,031             |
| Renato PAGLIARO             | Telecom Italia        | Savings         |                 | 45,000    |           | 45,000             |

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|                   |                       |          |              |           |
|-------------------|-----------------------|----------|--------------|-----------|
| Pasquale PISTORIO | Telecom Italia        | Ordinary | 1,549,000(8) | 1,549,000 |
| Luigi ROTH        | Telecom Italia        | Ordinary |              |           |
|                   | Telecom Italia Mobile | Ordinary | 11,553(4)    | 11,553    |
|                   |                       |          | 14,300(4)    | 24,739(9) |
|                   | Telecom Italia Media  | Ordinary | 726(4)       | 726       |

- 
- (1) Telecom Italia shares resulting from the exchange ratio (1.73 Telecom Italia Ordinary Shares for every Telecom Italia Mobile ordinary share) between Telecom Italia Mobile shares (No. 1,125,000) and Telecom Italia shares following the date the merger by incorporation of Telecom Italia Mobile in Telecom Italia became effective (June 30, 2005).
- (2) Telecom Italia Mobile shares delivered under the tender offer.
- (3) Telecom Italia shares resulting from the exchange ratio (1.73 Telecom Italia Ordinary Shares for every Telecom Italia Mobile ordinary share) between Telecom Italia Mobile shares (No. 3,460) and Telecom Italia shares following the date the merger by incorporation of Telecom Italia Mobile in Telecom Italia became effective (June 30, 2005).
- (4) Shares held indirectly.
- (5) Telecom Italia shares resulting from the exchange ratio (1.73 Telecom Italia Ordinary Shares for every Telecom Italia Mobile ordinary share) between Telecom Italia Mobile shares (No. 3,500) and Telecom Italia shares following the date the merger by incorporation of Telecom Italia Mobile in Telecom Italia became effective (June 30, 2005).
- (6) Telecom Italia shares resulting from the exchange ratio (2.36 Telecom Italia Savings Shares for every Telecom Italia Mobile savings share) between Telecom Italia Mobile shares (No. 5,000) and Telecom Italia shares following the date the merger by incorporation of Telecom Italia Mobile in Telecom Italia became effective (June 30, 2005).
- (7) Telecom Italia shares resulting from the exchange ratio (2.36 Telecom Italia Savings Shares for every Telecom Italia Mobile savings share) between Telecom Italia Mobile (shares No. 4,700) and Telecom Italia shares following the date the merger by incorporation of Telecom Italia Mobile in Telecom Italia became effective (June 30, 2005).
- (8) Including 660,000 shares held indirectly.
- (9) Telecom Italia shares resulting from the exchange ratio (1.73 Telecom Italia Ordinary Shares for every Telecom Italia Mobile ordinary share) between Telecom Italia Mobile shares (No. 14,300) and Telecom Italia shares following the date the merger by incorporation of Telecom Italia Mobile in Telecom Italia became effective (June 30, 2005).



**Table of Contents****Item 7. Major Shareholders And Related-Party Transactions****Major Shareholders**V **BOARD OF AUDITORS**

The following table shows the ownership of Telecom Italia, TIM and Telecom Italia Media shares, as of May 10, 2006, by the auditors of Telecom Italia:

| <u>Name</u>                 | <u>Company</u>        | <u>Class of shares</u> | <u>Number of shares held at the end of 2004 (or at the date of appointment)</u> | <u>Number of shares purchased</u> | <u>Number of shares sold</u> | <u>Number of shares held as of May 10, 2006 (or as of the date on which individual left post, if before)</u> |
|-----------------------------|-----------------------|------------------------|---|-----------------------------------|------------------------------|--|
| Paolo GOLIA                 | Telecom Italia Mobile | Ordinary               | 12,000  |                                   | 11,169(1)                    | 1,437(2)   |
| Ferdinando SUPERTI<br>FURGA | Telecom Italia Mobile | Ordinary               | 3,723   |                                   | 3,723                        |  |

(1) Telecom Italia Mobile shares delivered under the Cash Tender Offer.

(2) Telecom Italia shares resulting from the exchange ratio (1.73 Telecom Italia Ordinary Shares for every Telecom Italia Mobile ordinary share) between Telecom Italia Mobile shares (No. 831) and Telecom Italia shares following the date the merger by incorporation of Telecom Italia Mobile in Telecom Italia became effective (June 30, 2005).

As of May 10, 2006 no member of the Board of Directors or Board of Auditors beneficially owned more than 0.0002066% of the Ordinary Shares or Savings Shares.

The following table shows certain information, as of May 10, 2006, about the ownership of the Company's Ordinary Shares and Savings Shares by the Company's directors and executive officers as a group and by the members of the Board of Auditors as a group.

| <u>Title of Class</u> | <u>Owner</u>  | <u>Number Owned</u> | <u>% of class</u> |
|-----------------------|---|---------------------|-------------------|
| Ordinary Shares       | Directors and executive officers as a group (21 Directors and 8 Executive Officers) | 5,648,518           | 0.0422139         |
|                       | Board of Auditors as a group (5 persons)  | 1,437               | 0.0000107         |
| Savings Shares        | Directors and executive officers as a group (21 Directors and 8 Executive Officers) | 2,147,031           | 0.0356287         |
|                       | Board of Auditors as a group (5 persons)  |                     |                   |

Effective from April 1, 2006, according to article No. 114, prf. 7, of Legislative Decree No. 58/1998, as amended by law No. 262/2005, and pursuant to ad hoc rules by Consob, persons performing administrative, supervisory and management functions in a

listed issuer (including directors and auditors) and managers who have regular access to inside information (so called "privileged information", in accordance with the definition of law No. 262/2005) and the power to make managerial decisions affecting the future development and prospects of the issuer, persons who hold shares amounting to at least 10 per cent of the share capital, and any other persons who control the issuer must inform Consob and the public of transactions involving the issuer's shares (or the shares issued by the issuer's listed subsidiaries, and unlisted shares issued by subsidiaries of the listed issuer when the book value of the holding in the subsidiary represents more than fifty per cent of the listed issuer's assets) or other financial instruments linked to them that they have carried out directly or through nominees, for an amount equal to or above 5,000. Such disclosures must be performed within a five-trading day time limit and have also to be made when the transactions are carried out by the spouse, unless legally separated, dependent children, including those of the spouse, cohabitant parents and relatives by blood or affinity of the persons referred to above.

The aforementioned requirement applies to Telecom Italia's Directors, Auditors and Executive Officers.

As a result, as from April 1, 2006, Telecom Italia's Code of Conduct for Insider Dealing is to be considered superseded and cancelled. The aforementioned Code of Conduct was a self-regulatory set of rules with a contractual value that set out the disclosure requirements and rules applicable to transactions, involving financial instruments issued by the Company and its subsidiaries, carried out by persons who, as a consequence of their position in the Company, used to have access to material information (that is information on matters capable of

**Table of Contents****Item 7. Major Shareholders And Related-Party Transactions****Major Shareholders**

producing significant changes in the outlook for the profitability, financial position and/or balance sheet of the Company and the Telecom Italia Group and likely, if made public, to have a significant effect on the price of the listed securities in question). To this end the relevant persons included among others Directors, executive officers and Statutory Auditors.

The Code required immediate disclosure to the market of transactions whose amount, aggregated with the amounts of other transactions carried out in the three preceding months and not yet declared to the Company, exceeded 80,000, and quarterly disclosure of transactions whose cumulative amount was more than 35,000 and less than 80,000.

In addition, the Code provided for black-out periods during which, in general, persons subject to the disclosure obligations were not allowed to carry out transactions.

In the event of non-compliance, the Code provides for severe penalties; where the offender is a Director or a member of the Board of Auditors, the Board of Directors may propose the revocation of his or her appointment at the next shareholders' meeting. If the offender (including an executive officer) is an employee, penalties set forth by applicable laws and collective agreements will apply.

**7.1.3 CONTINUING RELATIONSHIP WITH THE ITALIAN TREASURY**

Since December 9, 2002, the Treasury has not held a direct holding in Telecom Italia. However, the Treasury continues to be 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. Such powers were established in 1997 according to Law No. 474/1994, when Telecom Italia formerly controlled by the Italian Treasury was privatized.

On May 22, 2003, taking into account the proposed Merger, a Decree by the Minister for Economy and Finance, in agreement with the Minister for Productive Activities, maintained the power of approving the acquisition of major shareholdings in the company's voting capital (3% of Telecom Italia's voting share capital or more) and the power of veto over resolutions to dissolve the company, approve mergers, demergers or dispositions of the business, transfer the registered office abroad, change the corporate purposes or amend or modify the special powers. On the other hand, the Treasury's power to approve major shareholders' agreements and the power to appoint one Director and one Statutory Auditor were relinquished.

Law No. 350/2003, adopted in December 2003, significantly modified the rules governing the special powers of the Italian Government with respect to privatized companies stating, in particular, that the Government no longer has the power to approve or disapprove the acquisition of material interests in the share capital of such companies, but instead may object, within a ten-day period, in case of prejudice to vital State interests and each time there is the need to protect subsequent undeniable reasons of public interest, in accordance with specific criteria set forth in an ad-hoc decree of the Government dated June 10, 2004.

As a result, on April 1, 2005 a new Decree by the Minister for Economy and Finance, in agreement with the Minister for Productive Activities redefined accordingly the content of the special powers clause in Telecom Italia's bylaws, and stated its exact wording.

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Therefore, as per the power entrusted to the Board of Directors by the Company's bylaws, according to Italian Civil Code, to resolve upon revisions of the bylaws, if necessary to conform with statutory provisions, on October 5, 2005 the Telecom Italia Board of Directors amended the relevant provision.

In December 2004, Telecom Italia, pursuant to Article No. 22.b) of its bylaws, notified the Minister for the Economy and Finance of the commencement of the plan for the reorganization of the Telecom Italia Group, which included the merger of TIM with and into Telecom Italia, and subsequently notified the Minister of the adoption of the One Company Model, which entailed the merger of Tim Italia with and into Telecom Italia. In neither case did the Minister for the Economy and Finance exercise its veto power.

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**Item 7. Major Shareholders And Related-Party Transactions**

**Related-Party Transactions**

**7.2 RELATED-PARTY TRANSACTIONS**

Related party transactions, including intragroup transactions, are neither unusual nor exceptional but fall under the normal business operations of the companies of the Group. Such transactions, when not concluded as standard conditions or dictated by specific laws, are in any case conducted at arm's length.

For further details, please see Note 39 Other Information of the Notes to the Consolidated Financial Statements.

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**Item 8. Financial Information**

**HISTORICAL Financial Statements**

**Reconciliation From Previous GAAP (ITALIAN GAAP) To IFRS**

**Item 8. FINANCIAL INFORMATION**

**8.1 HISTORICAL FINANCIAL STATEMENTS**

See Items 18 and 19 for a list of financial statements and other financial information filed with this report.

**8.2 RECONCILIATION FROM PREVIOUS GAAP (ITALIAN GAAP) TO IFRS**

See Note 42 Transition to the International Financial Reporting Standards (IFRS) of the Notes to the Consolidated Financial Statements included elsewhere herein.

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**Item 8. Financial Information**

**Legal Proceedings**

**8.3 LEGAL PROCEEDINGS**

For further details, please see Note 25 Commitments and Potential Liabilities of the Notes to the Consolidated Financial Statements included elsewhere herein.

**Table of Contents****Item 9. Listing****Trading Of Telecom Italia Ordinary Shares And Savings Shares****Item 9. LISTING****9.1 TRADING OF TELECOM ITALIA ORDINARY SHARES AND SAVINGS SHARES**

The principal trading market for the Ordinary Shares and the Savings Shares is on Telematico, an automated screen trading system managed by Borsa Italiana. (see 9.3 Securities Trading in Italy ).

Following the Merger, which became effective on August 4, 2003, Olivetti as the surviving company changed its name to Telecom Italia S.p.A. , succeeded to the 1934 Act registration of Old Telecom Italia and became subject to the foreign private issuer reporting requirements of the Exchange Act.

Ordinary and Savings Share ADSs, each representing respectively ten Ordinary Shares and ten Savings Shares, have been quoted on the NYSE since August 4, 2003. JPMorgan Chase Bank is the Company's Depository issuing ADRs evidencing the Ordinary Share ADSs and the Savings Share ADSs.

The table below sets forth, for the periods indicated, reported high and low official prices of the Ordinary Shares on Telematico and high and low closing prices of Ordinary Share ADSs on the NYSE from August 4, 2003.

|                            | Telematico |       | NYSE     |       |
|----------------------------|------------|-------|----------|-------|
|                            | High       | Low   | High     | Low   |
|                            | ( )        |       | (U.S.\$) |       |
| <b>2005:</b>               |            |       |          |       |
| First Quarter              | 3.168      | 2.79  | 41.16    | 36.93 |
| Second Quarter             | 2.978      | 2.486 | 38.59    | 30.14 |
| Third Quarter              | 2.734      | 2.479 | 33.86    | 29.95 |
| Fourth Quarter             | 2.719      | 2.305 | 32.13    | 26.95 |
| <b>2006:</b>               |            |       |          |       |
| January                    | 2.614      | 2.309 | 31.87    | 28.09 |
| February                   | 2.363      | 2.257 | 28.35    | 26.89 |
| March                      | 2.477      | 2.293 | 29.81    | 27.48 |
| April                      | 2.427      | 2.238 | 30.21    | 28.02 |
| May (through May 10, 2006) | 2.314      | 2.231 | 29.71    | 27.90 |

Source: Bloomberg data



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At the close of business on May 10, 2006 there were 28,537,534 Ordinary Share ADSs outstanding held by 139 registered holders. One of the registered holders is the Depository Trust Company ( **DTC** ) which holds 28,521,231 Ordinary Share ADSs on behalf of beneficial holders.

The table below sets forth, for the periods indicated, reported high and low official prices of the Savings Shares on Telematico and high and low closing prices of the Savings Share ADSs on the NYSE from August 4, 2003.

|                            | Telematico |       | NYSE     |       |
|----------------------------|------------|-------|----------|-------|
|                            | High       | Low   | High     | Low   |
|                            | ( )        |       | (U.S.\$) |       |
| <b>2005:</b>               |            |       |          |       |
| First Quarter              | 2.519      | 2.303 | 32.90    | 30.71 |
| Second Quarter             | 2.540      | 2.052 | 32.51    | 24.64 |
| Third Quarter              | 2.306      | 2.063 | 27.97    | 24.75 |
| Fourth Quarter             | 2.301      | 1.938 | 26.94    | 22.32 |
| <b>2006:</b>               |            |       |          |       |
| January                    | 2.220      | 1.951 | 27.02    | 23.72 |
| February                   | 2.015      | 1.907 | 24.02    | 22.70 |
| March                      | 2.243      | 1.955 | 27.12    | 23.33 |
| April                      | 2.212      | 1.985 | 27.13    | 24.65 |
| May (through May 10, 2006) | 2.087      | 1.984 | 26.66    | 24.66 |

Source: Bloomberg data

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**Item 9. Listing**

**Trading Of Telecom Italia Ordinary Shares And Savings Shares**

At the close of business on May 10, 2006, there were 26,855,133 Savings Share ADSs outstanding held by 12 registered holders.

One of the registered holders is the Depository Trust Company ( **DTC** ) which holds 26,852,631 Savings Share ADSs on behalf of beneficial holders.

Fluctuations between the Euro and the U.S. Dollar will affect the dollar equivalent of the price of the Ordinary Share and the Savings Shares on Telematico and the price of the Ordinary Share ADSs and the Savings Share ADSs on the New York Stock Exchange. On May 10, 2006, the Noon Buying Rate for the Euro was U.S.\$1.2799= 1.00.

**Table of Contents****Item 9. Listing****Trading Of Old Telecom Italia Ordinary Shares And Savings Shares****9.2 TRADING OF OLD TELECOM ITALIA ORDINARY SHARES AND SAVINGS SHARES**

The table below sets forth, for the periods indicated, reported high and low official prices of the Ordinary Shares of Old Telecom Italia on Telematico and high and low closing prices of Ordinary Share ADSs of Old Telecom Italia on the NYSE until and including August 1, 2003.

|                                      | Telematico |       | NYSE     |       |
|--------------------------------------|------------|-------|----------|-------|
|                                      | High       | Low   | High     | Low   |
|                                      | ( )        |       | (U.S.\$) |       |
| <b>2001:</b>                         |            |       |          |       |
| First Quarter                        | 13.42      | 10.50 | 127.50   | 95.55 |
| Second Quarter                       | 12.34      | 9.52  | 113.25   | 83.00 |
| Third Quarter                        | 10.74      | 6.40  | 94.50    | 60.00 |
| Fourth Quarter                       | 9.82       | 8.00  | 90.53    | 75.50 |
| <b>2002:</b>                         |            |       |          |       |
| First Quarter                        | 9.73       | 8.55  | 88.75    | 75.18 |
| Second Quarter                       | 9.21       | 7.49  | 85.00    | 74.60 |
| Third Quarter                        | 8.35       | 7.08  | 83.20    | 71.35 |
| Fourth Quarter                       | 8.31       | 7.03  | 85.25    | 70.45 |
| <b>2003:</b>                         |            |       |          |       |
| First Quarter                        | 7.53       | 5.31  | 80.19    | 58.65 |
| Second Quarter                       | 8.14       | 6.61  | 94.43    | 70.14 |
| Third Quarter (until August 1, 2003) | 8.05       | 7.47  | 91.10    | 84.30 |

Source: Reuters data.

The table below sets forth, for the periods indicated, reported high and low official prices of the Savings Shares of Old Telecom Italia on Telematico and high and low closing prices of the savings share ADSs of Old Telecom Italia on the NYSE until and including August 1, 2003 for the period following such date.

|                | Telematico |      | NYSE     |       |
|----------------|------------|------|----------|-------|
|                | High       | Low  | High     | Low   |
|                | ( )        |      | (U.S.\$) |       |
| <b>2001:</b>   |            |      |          |       |
| First Quarter  | 6.84       | 5.44 | 63.38    | 52.50 |
| Second Quarter | 6.89       | 5.05 | 61.00    | 45.94 |
| Third Quarter  | 5.83       | 3.63 | 50.50    | 37.50 |
| Fourth Quarter | 5.85       | 4.44 | 52.29    | 49.00 |
| <b>2002:</b>   |            |      |          |       |
| First Quarter  | 6.20       | 5.21 | 55.96    | 47.51 |

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|                                      |      |      |       |       |
|--------------------------------------|------|------|-------|-------|
| Second Quarter                       | 6.14 | 4.94 | 57.00 | 50.32 |
| Third Quarter                        | 5.50 | 4.80 | 56.50 | 53.00 |
| Fourth Quarter                       | 5.38 | 4.77 | 56.33 | 48.67 |
| <b>2003:</b>                         |      |      |       |       |
| First Quarter                        | 4.90 | 3.35 | 52.00 | 37.50 |
| Second Quarter                       | 4.96 | 3.94 | 57.59 | 42.50 |
| Third Quarter (until August 1, 2003) | 5.08 | 4.64 | 53.75 | 52.92 |

Source: Reuters data.

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**Table of Contents****Item 9. Listing****Securities Trading In Italy****9.3 SECURITIES TRADING IN ITALY**

Since July 1994, all Italian equity securities have been traded on Telematico except for equity securities of (i) certain smaller companies and cooperative banks traded on Mercato Ristretto under certain specific rules concerning trading hours and procedures and (ii) high growth companies traded on Nuovo Mercato.

Telematico operates under the control of CONSOB, the public authority charged, among other things, with regulating securities markets and all public offerings of securities in Italy, and is managed by Borsa Italiana a joint stock company previously owned by the Treasury, sold through a tender offer to authorized intermediaries.

Securities transactions on Telematico are settled on a cash basis. Cash transactions are settled on the third trading day following the trading date. Borsa Italiana issues a daily official list with certain information on transactions in each listed security, including the volume traded and the high and low prices of the day. No closing price is reported, but an official price calculated as a weighted average price of all trades effected during the trading day and a reference price calculated as a weighted average of the last 10% of tender effected during such day are reported daily. The Bank of Italy, in accordance with CONSOB, regulates the governing of the clearing system; with a provision dated September 8, 2000, the Bank of Italy specifies that the clearing system be performed by Monte Titoli (a centralized securities clearing system owned by certain major Italian banks and financial institutions).

Residents of Italy and non-residents through their authorized agents may purchase or sell shares on Telematico, subject to satisfying (i) in case of sales, either the Margin or the Deposit, and (ii) in case of purchases, the Margin. Margin means a deposit equal to 100% of the agreed price, and Deposit means a deposit of an equal number of the same shares as those sold. If in the course of a trading day the maximum price variation between two consecutive contracts is  $\pm 5\%$ , or maximum price variation of the contracts with respect to the control price is  $\pm 10\%$  an automatic five-minute suspension is declared. In the event of such a suspension, effect is not given to trades agreed but not confirmed before the suspension. In addition, Borsa Italiana has the authority to suspend trading in any security in response to extreme price fluctuations or for other reasons.

Starting May 15, 2000, the most liquid shares traded on Telematico, including the Ordinary Shares and the TIM ordinary shares, have been traded on Mercato After Hours, an automated screen trading system managed by Borsa Italiana. Mercato After Hours operates, from 6.00 p.m. to 8.30 p.m. on every trading day, substantially under the same rules as Telematico except that the price of any security may not fluctuate by more than 3.5% from the reference price of said securities on Telematico on the same day.

The S&P/MIB currently measures the performance of 40 equities listed on the markets organized and managed by Borsa Italiana. The index is derived from the universe of stocks trading on the Italian Exchange, including Borsa (MTA) and Nuovo Mercato. In September 2004, the S&P/MIB index substituted the MIB30 index which is calculated as an informative index. The S&P/MIB Index provides diversity over 10 economic sector by adhering to the Global Industry Classification Standard, or CIGS. The 10 CIGS sectors that underlie the S&P/MIB are: Consumer Discretionary, Consumer Staples, Energy, Financials, Health care, Industrials, Information Technology, Materials, Telecommunication Services and Utilities. All stocks are classified using the CIGS methodology, therefore S&P/MIB Index reflect the Italian Markets in its entirety. Each constituent is weighted by its free float capital, considering the effective number of shares tradable in the market. Index Constituents are reviewed twice a year (March and September), whereas the rebalancing weights are re-calculated four times a year (March, June, September and December). The weighting structure can also be changed following extraordinary events (if the capital of a stock increases or other events).

American style call and put options are traded on the derivative market managed by Borsa Italiana which currently include the Ordinary and Savings Shares.

Effective July 1, 1998, the Italian financial markets have been regulated by the Draghi Law. With the Draghi Law, the Italian Government has introduced new laws and regulations governing some aspects of the financial sector and, in particular: (i) brokers and firms managing financial instruments; (ii) the Italian regulated Stock Exchanges; (iii) the offering to the public of financial instruments; (iv) public tender offers; (v) some aspects of corporate governance of listed companies; and (vi) insider trading. The Draghi Law contains framework provisions which have been implemented by specific regulations.

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**Item 9. Listing**

**Clearance And Settlement Of Telecom Italia Shares**

**9.4 CLEARANCE AND SETTLEMENT OF TELECOM ITALIA SHARES**

Legislative Decree No. 213 of June 24, 1998 ( Dematerialization Decree ) provided for the dematerialization of financial instruments publicly traded on regulated markets including treasury bonds. From July 9, 1998, all companies that issue financial instruments that are publicly traded on regulated markets must inform Monte Titoli, which will open an account in the name of each company in its register.

Beneficial owners of Ordinary Shares and Savings Shares must hold their interests through specific deposit accounts with any participant having an account with Monte Titoli. The beneficial owners of Ordinary Shares and Savings Shares held with Monte Titoli may transfer their shares, collect dividends, create liens and exercise other rights with respect to those Ordinary Shares and Savings Shares through such accounts and may no longer obtain physical delivery of share certificates in respect of their Ordinary Shares and Savings Shares. All new issues of Ordinary Shares and Savings Shares and all other transactions involving Ordinary Shares and Savings Shares must settle electronically in book-entry form.

Ordinary Shares and Savings Shares are accepted for clearance through Euroclear and Clearstream. Holders of shares may elect to hold such Ordinary Shares and Savings Shares through Euroclear or Clearstream (outside the United States).

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Item 10. Additional Information

Corporate Governance

**Item 10. ADDITIONAL INFORMATION****10.1 CORPORATE GOVERNANCE****10.1.1 DIFFERENCES IN TELECOM ITALIA S CORPORATE GOVERNANCE AND NEW YORK STOCK EXCHANGE CORPORATE GOVERNANCE PRACTICES**

In November 2003, the SEC approved the NYSE's new corporate governance rules for listed companies. Under these new rules, as a NYSE-listed foreign private issuer, Telecom Italia must disclose any significant ways in which its corporate governance practices differ from those followed by US companies under NYSE listing standards. We believe the following to be the significant differences between our corporate governance practices and NYSE corporate governance rules applicable to US companies.

*Independent Directors.* Under NYSE listing rules applicable to US companies, independent directors must comprise a majority of the board of directors. As of April 13, 2006, with the replacement of two non independent directors by two independent ones, Telecom Italia's Board maintains and increases the number of independent directors (13 out of 21; in 2005 they were 11 out of 21), with the status of independence determined under Italian Listing Standards and Telecom Italia Internal Regulations (Self-Regulatory Code).

See also below under 10.1 Corporate Governance 10.1.2 General Board of Directors Independent Directors .

*Non-management Directors Meetings.* Pursuant to NYSE listing standards, non-management directors must meet on a regular basis without management present and independent directors must meet separately at least once per year. There are no corresponding provisions under Italian rules.

During 2004, the Board of Directors decided it was desirable to appoint a Lead Independent Director, with the aim of further enhancing the role of the independent directors. Professor Guido Ferrarini, Chairman of the Internal Control and Corporate Governance Committee, was chosen to be the Lead Independent Director. The Lead Independent Director is authorized to call, at his own initiative or at the request of other directors, special meetings of the independent directors (Independent Directors Executive Sessions) to discuss issues related to the functioning of the Board or to the business of the company.

During 2005, five Independent Directors Executive Sessions took place; the main extraordinary corporate actions were examined as well as some issues concerning management remuneration and incentives. In accordance with international best practice, the independent directors also carried out a management evaluation, the results of which were shared with the other non-executive directors in a special session of the Board as a whole, without executive directors attending the meeting.



See also below under 10.1 Corporate Governance 10.1.2 General Board of Directors Executive Directors and Activities of the Board .

*Nominating/Corporate Governance Committee.* Under NYSE standards, US companies listed on the NYSE are required to have a nominating/corporate governance committee composed entirely of independent directors. In addition to identifying individuals qualified to become board members, this committee must develop and recommend to the board a set of corporate governance principles. Pursuant to NYSE standards, this committee should also adopt a written charter.

Telecom Italia does not have a nominating committee. Directors are appointed by shareholders through the *voto di lista* system which permits shareholders, who alone or together, hold shares representing at least 1% of the share capital to put forward slates of directors. The system is intended to ensure that minority shareholders will have representation on the Board and in January 2006 became mandatory, pursuant to new article No. 147-ter of the Draghi Law.

Telecom Italia does have an Internal Control and Corporate Governance Committee made up solely of independent directors. Among its other activities, this committee actively participated and assisted in developing and implementing the corporate governance procedures adopted by Telecom Italia.

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**Item 10. Additional Information**

**Corporate Governance**

See also below under 10.1 Corporate Governance 10.1.2 General Board of Directors Internal Committees .

*Compensation Committee.* Under NYSE standards, US companies listed on the NYSE are required to establish a compensation committee composed entirely of independent directors. In addition to the review and approval of corporate goals relevant to CEO compensation and evaluation of the CEO performance in light of those given, this committee must determine and approve the CEO's compensation and make recommendations to the Board of Directors with respect to non-CEO compensation, incentive-compensation plans and equity-based plans.

In accordance with Telecom Italia's Bylaws and the Self-Regulatory Code, the Board of Directors determines the remuneration of the Chairman and the Managing Directors. Such determination is made after consultation with the Remuneration Committee, which is composed solely of independent directors. The Remuneration Committee provides advice regarding remuneration criteria for the Company's senior management.

See also below under 10.1 Corporate Governance 10.1.2 General Board of Directors Internal Committees .

*Audit Committee.* US companies listed on the NYSE are required to establish an audit committee that satisfies the requirements of Rule 10A-3 under the 1934 Act. In particular, all members of this committee must be independent and the committee is required to adopt a written charter. Among others, this committee should have the responsibility for the preparation of an audit committee report, the appointment, compensation, retention, oversight of the external auditors, establishing procedures for the receipt and treatment of (anonymous) complaints, discovery with management and the external auditors and setting hiring policies for employees or former employees of the external auditors. The Board of Auditors, as permitted by Rule 10A-3, is performing this function for Telecom Italia, which therefore is exempted from the requirement separately to have an audit committee. A Rule 303A written affirmation to this end was submitted to NYSE on July 29, 2005. See also below under 10.1 Corporate Governance 10.1.2 General Board of Directors Internal Control System and 10.1.2 General Board of Directors Board of Auditors .

*Adoption and Disclosure of Corporate Governance Guidelines.* US companies listed on the NYSE are required to adopt and disclose corporate governance guidelines. Such disclosures are included in this Form 20-F and English translations of the Telecom Italia Group's corporate governance policies can be found on Telecom Italia's website: [www.telecomitalia.it](http://www.telecomitalia.it) under governance .

*Code of business conduct and ethics.* NYSE listing standards require US companies to adopt a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers. The code should provide for the reporting of violations of its provisions or of laws and regulations. Telecom Italia has adopted such a Code. See also below under 10.1 Corporate Governance 10.1.2 General Code of Ethics and Conduct .

*Annual Certification by The Chief Executive Officer.* A chief executive officer of a US company listed on the NYSE must annually certify that he or she is not aware of any violation by the company of NYSE corporate governance standards. In accordance with NYSE listing rules applicable to foreign private issuers, Telecom Italia submitted its initial foreign private issuer annual written affirmation on July 29, 2005.

**10.1.2 GENERAL**

In general, the Company's corporate governance system is based on the central role of the Board of Directors, transparency in operational decisions, effective internal controls and rigorous rules governing conflicts of interest. This system, designed and constructed bearing in mind the principles formulated by the Committee for Corporate Governance of Borsa Italiana (known as the Preda Code), has been implemented with the adoption of codes, rules and procedures covering the activity of all the organizational and operational components of the Company. These documents (available also in English version on the Internet website: [www.telecomitalia.it](http://www.telecomitalia.it) under Investors ) are:

- the Group Code of Ethics and Conduct;
- the Company's Self-Regulatory Code;

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- the Guidelines for Transactions with Related Parties;
- the Procedure for Compliance with the Requirements of Article No. 150.1 of Italian Legislative Decree No. 58/1998;
- the Disclosure Committee Rules;
- the Group Procedure for the Appointment of External Auditors; and
- the Procedure for the management and public disclosure of inside information.

The above documents are reviewed regularly and updated to reflect legislative and regulatory developments and changes in operational practice. A general update is under progress and is expected to take place concurrently with the revision of the bylaws, which is compulsory by January 2007 to conform with Law No. 262/2005 ( Provisions for the protection of savings and the regulation of financial markets ). The review will also consider the March 2006 edition of the Corporate Governance Code by Borsa Italiana; issuers were invited to implement this Code by the end of the fiscal year starting in 2006, informing the market through the Report on Corporate Governance to be published in 2007. According to new article No. 124-bis of the Draghi Law, listed issuers shall annually disclose information on their adoption of codes of conduct promoted by management companies of regulated markets (such as the aforementioned Corporate Governance Code by Borsa Italiana) or by trade associations of market participants and on their compliance with the consequent obligations, explain the reasons for any failures to comply.

**V CODE OF ETHICS AND CONDUCT**

The Code of Ethics and Conduct (the Code of Ethics ) of the Telecom Italia Group is central to Telecom Italia Group s system of corporate governance as it represents the fundamental values and principles that serve to ensure an ethically-oriented conduct of business. The Code of Ethics, which has gradually been adopted by all the companies belonging to the Telecom Italia Group, specifies objectives and values to be respected in the interest of Telecom Italia s principal stakeholders: shareholders, financial markets, customers, local communities and employees.

As with all of the Company s corporate governance codes and principles, the Code of Ethics is reviewed regularly in order to conform it to the developments in the applicable law and market practice, taking into account review by the persons in charge of internal control at the companies level. The Code of Ethics applies to the executive bodies of all Group companies, their managements and all those who work for them (and, specifically, to executive, accounting and financial officers and controllers). The Code of Ethics addresses amongst others the ethical principles of Section 406 of the Sarbanes Oxley Act and deals with:

- honest and ethical conduct, including the handling of actual or apparent potential, direct or indirect, conflict of interest;
- full, accurate and timely disclosure in reports and documents to be filed or made public;

- compliance with any applicable law, rule and regulation;
- internal reporting of alleged violations of the Code of Ethics; and
- accountability for compliance of the Code of Ethics.

In addition, the Company's Self-Regulatory Code, the Guidelines for Transactions with Related Parties, the Procedure for the Disclosure of Price-sensitive Information also deal with specific aspects of the same principles.

The Company will provide any interested person with a copy of the Code of Ethics, free of charge, upon request.

For further details, please see Item 16B. Code of Ethics and Conduct .

**V BOARD OF DIRECTORS**

The Company's Self-Regulatory Code supplements the applicable rules concerning the tasks and functioning of the Board of Directors of Telecom Italia. All the Company's directors are required to comply with the Self-Regulatory Code. The Self-Regulatory Code has been adopted by the Board of Directors as a self-regulatory

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### **Item 10. Additional Information**

### **Corporate Governance**

measure only and can therefore be amended at any time with a resolution adopted by the Board and promptly disclosed to the market.

In 2005, for the first time in Telecom Italia, the directors carried out a Board performance evaluation. The evaluation (carried out through the use of specific questionnaires) permitted two objectives to be pursued: on the one hand to check the working of the Board as a whole and on the other to assess the contributions to its activity and the conduct of the executive directors, the non-executive directors and the independent directors.

The analysis of the responses to the questionnaires revealed a generally positive assessment of the Board and its members but also some aspects susceptible to improvement. This permitted the identification of measures to make the organization of the Board more efficient and enhance its effectiveness, basically by increasing the involvement of the Board as a whole in issues addressed in a specialist manner by internal committees and organizing structured meetings with the management, with a consequent heightening of individual directors' appreciation of the matters of interest to the Company.

#### ***Role and tasks***

The Board of Directors has the power (and the duty) to lead the Company by pursuing the primary objective of creating value for its shareholders; to that end it takes all the decisions needed to achieve the corporate purpose (Article No. 2 of the Company's Self-Regulatory Code). The Company's Self-Regulatory Code reserves several especially important tasks exclusively to the Board, including those of:

- (i) examining and approving the strategic, business and financial plans of the Company and the Group;
- (ii) evaluating and approving the annual budget of the Company and the Group;
- (iii) examining and approving transactions including investments and divestments with a substantial impact on the Company's activity in view of their nature, strategic importance or size;
- (iv) verifying the adequacy of the general organizational and administrative structure of the Company and the Group;
- (v) preparing and adopting the Company's corporate governance rules and the Group's governance guidelines;
- (vi) nominating the persons who are to hold the offices of Chairman and Managing Director in strategic subsidiaries, except companies controlled by listed subsidiaries; and
- (vii) evaluating and approving the periodic reports required by the applicable legislation.

### **Meetings**

The Self-Regulatory Code requires the Board to meet periodically (and at least quarterly).

In 2005 the Board of Directors met eleven times. Board meetings were always well attended, with more than 88% of the directors present on average (the independent directors recorded an attendance rate of over 94%).

When board meetings were to be held, documentation permitting effective participation in the proceedings was normally provided in advance.

In November 2005, the Company released the calendar of corporate events scheduled in 2006, scheduling at least 5 meetings during the year.

### **Appointment**

Pursuant to Article No. 9 of Telecom Italia's Bylaws the Board of Directors is appointed by the Shareholders' Meeting through the *voto di lista* system. The Board of Directors has not less than 7 and not more than 23 members; it is up to the shareholders' meeting to decide the exact number.

The *voto di lista* system is designed to ensure an adequate representation on the Board of Directors of persons drawn from slates presented by minority shareholders.

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The slates of candidates are presented by the shareholders or by the outgoing Board of Directors; candidates are listed by means of progressive numbers. Each shareholder may submit only one slate, and each candidate may appear only on one slate. Only those shareholders who alone or together with other shareholders hold a total number of Ordinary Shares representing at least 1% of the share capital entitled to vote at the Shareholders Meeting may submit slates. The shareholders who put forward a slate are required to make available the profiles of the individual candidates (with an indication, where appropriate, of the grounds for their qualifying as independent) so that all the shareholders can know their personal and professional data and exercise the right to vote in an informed manner. Each person entitled to vote may vote for only one slate. Four-fifths of the directors to be elected are chosen from the slate that obtains the highest number of shareholders votes in the progressive order in which they are listed on the slate. The remaining directors are chosen from the other slates; the votes obtained by the various slates are successively divided by one, two, three, four or five, depending on the number of directors to be chosen, and the quotients obtained are assigned progressively to candidates on each of these slates, in the order respectively specified on the slate. The quotients thus assigned to the candidates on the various slates are arranged in a single decreasing order. Those candidates who have obtained the highest quotients are elected to the Board of Directors.

At the Shareholders Meeting on May 6, 2004, the slate of candidates proposed by Olimpia obtained the highest number of votes, and therefore four-fifths of the directors of Telecom Italia appointed at that date (those still in office are Marco Tronchetti Provera, Paolo Baratta (independent), Gilberto Benetton, Carlo Orazio Buora, Domenico De Sole (independent), Luigi Fausti (independent), Gianni Mion, Massimo Moratti, Marco Onado (independent), Renato Pagliaro, Carlo Alessandro Puri Negri, Luigi Roth (independent), Riccardo Ruggiero, John Robert Sotheby Boas (independent)) were chosen from Olimpia's candidates. The remaining Directors (they are Francesco Denozza (independent), Guido Ferrarini (independent), Jean Paul Fitoussi (independent), Pasquale Pistorio (independent)) were drawn from the slate presented by certain Italian institutional investors, jointly holding more than 1% of the Ordinary Shares.

The Shareholders Meeting held on April 7, 2005, increased the number of directors from 19 to 21 and appointed directors Marco De Benedetti and Enzo Grilli (independent), thus maintaining a majority of independent directors: 11 out of 21.

As on October 5, 2005 and January 23, 2006 respectively, Marco De Benedetti and Giovanni Consorte (neither of whom met applicable independence criteria) resigned, the Shareholders Meeting held on April 13, 2006 replaced them with Diana Bracco and Vittorio Merloni. Both of them qualify as independent, and therefore presently 13 out of 21 Directors are independent.

The curricula of the Directors in office are posted on the Company's website under Investors-Governance .

The resolutions taken by the Shareholders Meeting on April 7, 2005 and April 13, 2006 did not call for the application of the voto di lista system for electing the additional/replacing directors, as the Bylaws provide for such system to be used only in the case of renewal of the entire Board.

If during the term of the Board of Directors one or more directors ceases to hold such position for any reason, the Board of Directors is allowed to appoint replacements by a resolution approved by the Board of Auditors. The directors so appointed, if any, will remain in office until the next Shareholders Meeting. As a rule, the replacements finally appointed by the Shareholders Meeting will remain in office for the same term as the other members already in office at the time of their appointments; the Shareholders Meeting may establish a different term of office for them.



The Board of Directors appoints from its members a Chairman, if the Shareholders Meeting has not previously done so, and may appoint one Deputy Chairman, both of whom may be reappointed. The Board of Directors may also appoint one or more Managing Directors and determine his/their administrative powers. The Managing Director's term of office ends with the term of the Board of Directors which appoints him. The Chairman and the Managing Directors are Telecom Italia's legal representatives and in case of the Chairman's absence, for any reason, the Deputy Chairman will replace him.

Directors may serve for a maximum term of three years, they may be re-elected and there is no statutory age limit for their eligibility.

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There are no provisions in Italian law that set age or shareholding requirements for directors' qualification. There are no provisions in the Telecom Italia Bylaws relating to the retirement of a director under an age limit requirement or the number of shares required for director's qualification.

***Impact of Shareholders' Agreements on the Nomination of Telecom Italia Group's Companies Boards***

The parties to the Shareholders' Agreements have agreed to use their best efforts, within the limits established by law, in order to cause:

- the nomination by Edizione of one-fifth of the Boards of Directors, without taking into account the directors whose designation is reserved by law or applicable bylaws to the market or other parties;
- the nomination of one director by Intesa;
- the nomination of one director by Unicredit;
- the nomination of the vice-president of the Boards of Directors from among the directors nominated by Edizione; and
- in the event of the establishment of an Executive Committee, the election of one member of the Executive Committee from among the directors nominated by Edizione.

The nomination rights of Banca Intesa S.p.A. and UniCredito Italiano S.p.A. will fall away after their withdrawal becomes effective.

Pursuant to the Shareholders' Agreements, Pirelli pledged, to the extent allowed by law, that no decision will be made by the Board of Directors without the favorable vote of at least one of the Board members appointed by Edizione (if present) on the following points of business:

- individual investments greater than 250 million;
- purchase, sale and deeds of disposition for any reason whatsoever of controlling and connecting shareholdings with an individual value of more than 250 million;
- deeds of disposition for any reason whatsoever of businesses or assets individually greater than 250 million;

- proposals to call a Shareholders Extraordinary Meeting;
- transactions between the Olivetti group (and therefore now, after the Merger, the Telecom Italia Group) and the Pirelli group for amounts individually greater than 50 million; and
- transactions with related parties.

For a description of the transactions that involved Pirelli, Edizione Holding, IntesaBCI and Unicredit in acquiring a stake in Olivetti through Olimpia and the following agreements, please see Item 7. Major Shareholders and Related-Party Transactions 7.1 Major Shareholders 7.1.1 The Olimpia Shareholders Agreements .

### ***Independent Directors***

The Company has adopted specific criteria conforming to international best practice and the Preda Code to qualify directors as independent . On the basis of these criteria and in the light of the declarations submitted and the assessment carried out by the Board of Directors, 13 out of the 21 directors are considered independent, namely Paolo Baratta, Diana Bracco, Francesco Denozza, Domenico De Sole, Luigi Fausti, Guido Ferrarini, Jean Paul Fitoussi, Enzo Grilli, Vittorio Merloni, Marco Onado, Pasquale Pistorio, Luigi Roth and John Robert Sotheby Boas.

To qualify as independent under the Company s Self-Regulatory Code, Telecom Italia directors must:

- (i) neither have nor have recently had, directly, indirectly or on behalf of third parties, business relationships of a significance able to influence their autonomous judgment with the Company, its subsidiaries, the executive directors or the shareholder or group of shareholders who control the Company. The timeframe considered is the last three fiscal years for employment and executive directorships and the last fiscal year for other business relationships;

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- (ii) not hold, directly, indirectly or on behalf of third parties, equity interests allowing them to control the Company or exercise a significant influence over it;
- (iii) not participate in shareholders' agreements to control the Company or containing clauses regarding the composition of the Board of Directors or its decisions. This requirement is interpreted broadly, with an eye to the substantial independence that an independent director must enjoy. Accordingly, participation in shareholders' agreements precludes independence not only when a natural person, a director of the Company, participates directly in such an agreement but also when he has significant relationships with the natural or legal persons participating therein and is thus to be considered a representative of (some of) the parties to the agreements; and
- (iv) not be close relatives of executive directors of the Company or of persons in the situations indicated above (i.e. persons tied to the Group by significant business dealings; shareholders or groups of shareholders who control the Company or have a significant influence over it; participants in shareholders' agreements to control the Company or containing clauses regarding the composition of the Board of Directors or its decisions).

On September 9, 2004, the Board of Directors appointed as Lead Independent Director the Chairman of the Internal Control and Corporate Governance Committee (Mr. Ferrarini), in order to provide a point of reference and coordination for the needs and inputs of the independent directors. The Lead Independent Director is authorized to call special meetings of independent directors (so called Independent Directors Executive Sessions ) to discuss issues related to the functioning of the Board or the management of the business.

During 2005, five Independent Directors Executive Sessions took place; the main extraordinary corporate actions were examined as well as some issues concerning management remuneration and incentives. In accordance with international best practice, the independent directors also carried out a management evaluation, the results of which were shared with the other non-executive directors in a special session of the Board as a whole, without executive directors attending the meeting.

***Executive Directors and Activities of the Board***

The authority to grant delegated powers to directors and revoke such mandates is reserved to the Board of Directors, which also establishes the limits of such powers, the manner in which they may be exercised and the quarterly or shorter intervals at which persons with delegated powers must report to the Board of Directors and the Board of Auditors on the activity performed under the mandates conferred on them. The authority to determine the duties and responsibilities of the general managers is also reserved to the Board of Directors.

The Company has adopted an ad hoc procedure formalizing the rules for gathering and transmitting information to the Board of Auditors and the Board of Directors on the activity performed, transactions with major implications for the profitability, financial position and/or balance sheet of the Company and the Telecom Italia Group, transactions with related parties (including intra-group dealings) and atypical or unusual transactions (the Procedure for Compliance with the Requirements of Article No. 150.1 of Italian Legislative Decree No. 58/1998). This procedure generates the information flows by means of which the directors with delegated powers periodically report to the Board of Directors and the Board of Auditors not only on the steps they have taken under their mandates, through the organizational structure of the Company and its subsidiaries or otherwise, including the decisions adopted and the projects launched, but also on the implementation of transactions already approved by the Board of Directors.

In particular, the procedure provides for the collection and disclosure to Directors and members of the Board of Auditors of in-depth information on:

- the activity carried out by the Company, with special reference to the implementation of transactions already approved by the Board of Directors and the action taken by executive directors in the exercise of their delegated powers, including the projects launched;
- the transactions of greatest significance for the Company's profitability, financial position and balance sheet, highlighting the strategic goals, consistency with the budget and the business targets, the manner of implementation and developments, and any resulting constraints on or implications for the activity of the Telecom Italia Group;

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- any transactions potentially involving a conflict of interest, i.e. intra-group transactions and transactions with related parties other than those of an intra-group nature. The information on such transactions must indicate the underlying interest for the Company (and in the case of intra-group transactions their rationale within the context of the Telecom Italia Group), as well as the manner of implementation and the evaluation procedures followed; and
- atypical and unusual transactions, taken to mean those in which the subject or the nature of the transaction falls outside the normal sphere of the Company's business and those that have particularly critical aspects in relation to their nature, the risks inherent in the type of the counterparty or the time of their implementation. Here again the information provided must indicate the underlying interest for the Company and describe the manner of implementation of the transactions, with special reference to the evaluation procedures followed.

On May 6, 2004 the Board of Directors appointed Marco Tronchetti Provera as Chairman and Carlo Orazio Buora and Riccardo Ruggiero as Co-Chief Executive Officers (in Italy referred to as Managing Directors). Following the merger with TIM (specifically as from July 26, 2005) and until the adoption of the One Company Model (October 5, 2005) Marco De Benedetti was also a Managing Director.

Despite the broad scope of the mandates granted to the executive directors, the power to take decisions on transactions of particular significance continues to be exercised by the Board as a whole, even when they are theoretically within the limits of the executive directors' mandates. This is because delegating powers is not considered a way of attributing exclusive competences but as a means of ensuring, from the standpoint of organizing the management function, the greatest possible operational flexibility, both within the Company and in relation to third parties. Finally on July 26, 2005 the Board of Directors formally reclassified what had originally been defined as substantial limits of powers granted to executive directors (in terms of eligible transactions and amounts) as mere internal limits to the relationship of trust between the Board that delegates powers and the persons who exercise them. According to Italian law and the Company's Bylaws the Chairman and the Managing Directors are all legal representatives of the Company and they are individually authorized to carry out any transaction relating to the Company's activity.

On October 5, 2005, consistent with the adoption of the One Company Model, responsibility for the development of fixed, mobile and Internet services was assigned to the same person. This provides for the unitary direction of the business in addition to the unitary direction of corporate affairs. The consequent allocation of functions and related organizational responsibilities is set out below:

- Riccardo Ruggiero, Co-CEO (Managing Director), is responsible for Operations from the standpoint of the management and development of the business;
- Carlo Orazio Buora, Co-CEO (Managing Director), is responsible for the guidance and control of the business and for matters of a cross-over nature affecting the entire business; and
- Marco Tronchetti Provera, Chairman, is entrusted with coordinating the activity of the two Managing Directors and with establishing, together with them, the strategic guidelines for the Group and its development, with direct responsibility for the following areas: Institutional Affairs, Communications and Image, and Investor Relations.

The Company has adopted a series of guidelines on the way transactions with related parties are to be carried out (the Guidelines for Transactions with Related Parties). Their aim is to ensure both procedural and substantial fairness and transparency and to

involve the Board of Directors as a whole in the relevant decisions.

Under the Guidelines, the Board of Directors is required to give advance approval to transactions with related parties, including intra-group transactions apart from those of a customary nature to be concluded at standard conditions. To this end, provision is made for the Board of Directors to be adequately informed of all the relevant aspects (the nature of the relationship, the manner of carrying out the transaction, the economic and other conditions, the evaluation procedures used, the rationale for the transaction and the Company's interest in its implementation and the associated risks). Moreover, if the related party is a director or a third party that is related via a director, the director concerned may only provide clarifications and must leave the meeting when the motion is examined and voted upon; in this respect it should be noted that on two occasions the Board of Directors exempted directors who were related to the counterparty of the transaction on the agenda from leaving

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the meeting since a discussion was not considered necessary in light of the information received in preparation for the meetings. Depending on the nature, value and other characteristics of related-party transactions, the Board may be assisted by one or more outside experts engaged to give an opinion on their economic clauses and/or legitimacy and/or technical aspects, in order to prevent their being concluded at inappropriate conditions. Such experts must have suitable professional experience and qualifications in the relevant field and their independence and freedom from conflicts of interests must be carefully assessed.

The guidelines make it clear that the evaluation of conditions (as standard conditions) and transactions (as transactions of customary nature) must be made according to a ceteris paribus approach. In addition, on March 7, 2006, despite Consob not having issued the regulations provided by the so called Vietti reform (Legislative Decree No. 6/2003) and subsequent amendments, the Board of Directors approved a procedure designed to provide an objective basis for the treatment of specific situations; tests are under progress and the procedure is expected to come into full force during the year. Before any transaction is carried out, it will be necessary to consult an expert system (appropriately interfaced with a database that is being added to as the system is deployed) that will automatically provide on the basis of information gathered using ad hoc checklists indications concerning decision-making powers, internal information flows for reporting purposes, and the need for an external opinion in evaluating the congruousness of transactions.

Under Italian law where a director (either directly or on behalf of third parties) has an interest in any specific transaction of the company, such director is obliged to disclose this situation to the Board of Directors and the Board of Statutory Auditors and, in case he has been endowed with delegated powers, to abstain from any activity relating to the same transaction. (See Item 7. Major Shareholders and Related-Party Transactions 7.2 Related-Party Transactions ).

**Internal Committees**

According to article No. 13 of the Bylaws, the Board may set up committees from among its members charged with giving advice and making proposals and shall establish their powers and duties. Currently, the Board has established three committees: the Strategy Committee, the Internal Control and Corporate Governance Committee and the Remuneration Committee.

***Strategy Committee***

In September 2004, a Board of Directors Strategy Committee was established to increase the involvement of the Board in the Company's strategic decision-making, especially as regards guiding the evolutionary processes under way in the Telecom Italia Group's business in the light of the rapid transformation of technologies and markets.

The Committee is entrusted with the task of assisting the Board of Directors in making strategic choices in the light of competitive developments, with special reference to decisions concerning:

- the potential evolution of the structure of the telecommunications industry;



- the strategic positioning and business models of the Telecom Italia Group;
- the evolution of the Telecom Italia Group s organization in relation to its business models;
- the evolution of the Telecom Italia Group s corporate and financial structure; and
- the monitoring of the stage reached in the process of change.

The Committee reports on its activity to the Board of Directors at least once a year, at the time the budget is presented.

The Strategy Committee consists of the Chairman of the Board (who ensures the alignment and coordination of the activities of the Committee, the Board and management), the Managing Director charged with guidance and control corporate functions (and therefore not involved in the management of business, that is Carlo Orazio Buora), and three non-executive directors (Domenico De Sole, Marco Onado and Pasquale Pistorio) specialized in the fields of technology, organizational strategies and corporate finance.

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In addition to calling on the heads of units within the Company, the Committee may employ consultants and external experts.

The Committee met four times in 2005, generally at the same time as a meeting of the Board of Directors and with an attendance rate of 95%. The meetings were attended by managers of the Group, invited according to their specific expertise to provide inputs with regard to the matters on the agenda. The Committee examined and produced recommendations on the following subjects:

- Market scenarios: technological trends, evolution of consumption patterns, convergence initiatives by the main telecommunications operators - analysis of regulatory frameworks and the strategy and positioning of the Group with regard to telecommunications and, more generally, to information and communication technology (ICT).
- Internet: plans for the integration of platforms and business models (Tin.it, Virgilio and Rosso Alice).
- Sharpening the focus of the business.
- Strategic projects and international positioning: Europe, Mediterranean basin, Latin America.
- Integrated organizational model: basic principles, business objectives and the One Company Model.

***Internal Control and Corporate Governance Committee***

Pursuant to article No. 12 of the Self-Regulatory Code, the Board of Directors of Telecom Italia established a Committee for Internal Control and Corporate Governance, charged with advisory functions and the formulation of proposals. The Committee:

- (i) evaluates the adequacy of the internal control system;
- (ii) evaluates the work plan prepared by the person in charge of the oversight of the internal control system, from whom it receives periodic reports;
- (iii) discusses with the heads of the Company's administrative departments and the external auditors, and subsequently assesses, whether the accounting policies have been correctly applied and are homogeneous for the purpose of preparing the consolidated accounts;
- (iv) evaluates the proposals made by the external auditors in order to be awarded the appointment, the audit plan and the results set out in the letter of suggestions;

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- (v) reports to the Board of Directors at least once every half year on the activity performed and the adequacy of the internal control system;
- (vi) performs the additional tasks that may be assigned to it by the Board of Directors, particularly as regards relations with the external auditors; and
- (vii) monitors compliance with the rules of corporate governance and the periodic updating thereof.

The Committee is composed exclusively of non-executive, independent directors; it was appointed on May 6, 2004 and is made up of Directors Guido Ferrarini (Chairman of the Committee), Francesco Denozza, Domenico De Sole and Marco Onado.

In 2005 eleven meetings were held; attendance at the meetings was 100 per cent. Committee meetings are also attended by the Chairman of the Board of Auditors or by another auditor he designates. Where it is deemed desirable in the light of the issues on the agenda, the Committee and the Board of Auditors may hold joint meetings.

During the year the Committee contributed to the implementation of the Company's instruments of corporate governance and participated in the process of analyzing, specifying and updating them. It also played an active role in the integration of Telecom Italia and TIM, verifying the procedural correctness of valuations and the fairness of the operation. It examined the plan for the restructuring of the Group, with special reference to the merger of TIM into Telecom Italia and the concentration of the Group's Internet operations in the parent company. In addition, it analyzed the application of IAS/IFRS to the financial statements and kept abreast of the progress made by so called Project 404.

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As well as monitoring transactions that the Board deemed to be especially delicate, the Committee examined and approved the basic elements of the internal audit plan for 2006 and the quarterly plans of the person responsible for internal control. It periodically assessed the work of Telecom Italia Audit and Compliance Services S.c.a.r.l., paying particular attention to the company's report on internal auditing activity in 2005 and the checks it performed, and the progress made by the Group projects known as Control Risk Self-Assessment and Check-Up of Administrative Systems. In addition, the Committee discussed the plan for the 2006 statutory audits with representatives of the external auditors.

#### ***Remuneration Committee***

According to Telecom Italia's Self-Regulatory Code it is left to the Board of Directors to determine the remuneration of the Chairman and the Managing Directors, after examining the proposals of the Board's Remuneration Committee and consulting the Board of Auditors. The Board is also required to allocate the total compensation to be paid to the individual members of the Board and its committees if the shareholders' meeting has not already done so. Telecom Italia Shareholders' Meeting on May 6, 2004 fixed the overall compensation for the whole Board of Directors; such compensation was increased by the Shareholders' Meeting of April 7, 2005 (see Item 6. Directors, Senior Management and Employees 6.6 Compensation of Directors, Officers and Members of the Board of Auditors).

The Board's Remuneration Committee is charged with fact-finding and advisory functions. In particular, it formulates proposals for the remuneration of the directors who hold particular offices and (acting on a report by the Managing Directors) for the criteria for the remuneration of the Company's senior management.

The Committee is composed of non-executive/independent directors; it was appointed on May 6, 2004 and is made up of Directors Luigi Fausti (Chairman of the Committee), Paolo Baratta and Pasquale Pistorio. In 2005 the Committee met three times; the average attendance rate was approximately 90%.

#### **Internal Control System**

The Company's internal control system is conceived as a process for the achievement of substantial and procedural fairness, transparency and accountability by ensuring that corporate operations are efficient and can be known and verified, that accounting and operational data are accurate, that applicable laws and regulations are complied with, and that the assets of the business are safeguarded, not least with a view to preventing the perpetration of fraud against the Company and the consequent effects on shareholders.

The principal rules of Telecom Italia's internal control system are:

- separation of roles in the performance of the principal activities involved in each operating process;

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- traceability and constant visibility of decisions, so that responsibility can be pinpointed and the rationale identified; and
- decision-making on an objective basis, so that purely subjective considerations are set aside and decisions are taken according to criteria that are established in advance and can be verified.

The Board of Directors is responsible for the internal control system. It establishes the guidelines for the system and verifies that it is adequate and works effectively, making sure that the main corporate risks are appropriately identified and managed. To verify the correct operation of the internal control system the Board uses the Internal Control and Corporate Governance Committee and a suitably independent person endowed with sufficient resources to perform the internal control function: such person verifies the adequacy and effectiveness of the system and, where problems are identified, recommends the necessary remedies. In conformity with this approach, Telecom Italia has appointed the Company's internal auditor (Telecom Italia Audit and Compliance Services S.c.a.r.l.), in the person of its director assigned to the task, to be responsible for the oversight of its internal control system.

Telecom Italia Audit and Compliance Services S.c.a.r.l. is a consortium company, in which Telecom Italia Media also holds equity interests. The organizational solution adopted maximizes the independence of the appointed company in the performance of the internal audit function within Telecom Italia. Audit reports are submitted to the Internal Control and Corporate Governance Committee and the Board of Auditors.

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The CEO Carlo Orazio Buora is charged with the task of determining the mechanisms of the system and the manner in which it is to be implemented in accordance with the guidelines established by the Board; he is also responsible for ensuring the system's overall adequacy, its effectiveness and its adaptation to changes in operating conditions and the legislative and regulatory framework.

Any maintenance work that the person in charge of the oversight of the internal control system may recommend is performed by the competent sectors of the Company or Telecom Italia Group companies. The efficient operation of the system is promoted by the appointment of managers of particular standing and authority within the organization as persons in charge of implementation. In addition, in order to improve the deployment of the internal control system within the Group, in 2005 the position of Group Compliance Officer was created to ensure the overall coordination of the various implementation plans and thus guarantee, with the assistance of Telecom Italia Audit and Compliance Services S.c.a.r.l. methodological correctness in the management of risk. To further strengthen the system, the persons responsible for implementation have been flanked by compliance managers coordinated by the Group Compliance Officer.

The Telecom Italia Group's internal control system is completed by an ad hoc organizational model originally designed to meet the needs arising from Legislative Decree No. 231/2001 concerning the administrative liability of companies for criminal acts committed, in the interest or to the advantage of the same companies, by their employees or collaborators (in particular corporate crimes or crimes against the Public Administration, such as bribery, embezzlement or fraud). This model goes beyond the mere application of the provisions of Legislative Decree No. 231/2001, since it provides a paradigm for the conduct of all those who act in the Company's name and on its behalf. More specifically, the model which is based on the principles of the Code of Ethics and focused on situations where there is a significant risk of criminal acts comprises principles for dealings with governmental bodies (elaborated as a set of rules for relations with representatives of such bodies) and internal control checklists (i) listing the main stages of every process, (ii) the offences that may be committed in relation to individual processes, and (iii) the control activities to prevent the related risks from arising.

The organizational model is reviewed periodically in the light of experience in its application and changes to the law subsequent to the initial framework created by Legislative Decree No. 231/2001, including the broadening of its scope to encompass other cases. In 2005 the Company verified, in accordance with the discipline established by Legislative Decree No. 231/2001, the adequacy of the internal control system with respect to the new types of offence considered, with special reference to violations of company law. For the most part the results of the checks were satisfactory; for cases that were not fully regulated the 231 Organizational Model was supplemented as necessary with the adoption of some new internal control checklists for operational and instrumental processes exposed to the risk of offences being committed. At present the model is being fine tuned to incorporate the risks associated with the legislation on market abuse (Law No. 62/2005).

The functioning of the model and compliance with it are monitored by a Supervisory Panel composed of a member of the Board of Auditors (Ferdinando Superti Furga, Chairman of the Supervisory Panel), an independent director who is a member of the Committee for Internal Control and Corporate Governance (Guido Ferrarini) and the person in charge of the oversight of internal control system (Armando Focaroli). The panel's composition thus embraces all the professional skills that contribute to corporate control and highlights its autonomy.

The Supervisory Panel is expected to advise the Board of Directors in case the model needs adapting to changes in the legislative and regulatory framework, the nature of the Company's business activities and the ways they are conducted. It reports to the Board of Directors, the Committee for Internal Control and Corporate Governance and the Board of Auditors on the checks performed and their results.

A special unit has been created within Telecom Italia Audit and Compliance Services S.c.a.r.l. to provide operational support to the Supervisory Panels by handling reports of violations of the organizational model and conducting compliance audits on the basis of the data received through the information flows that have been put in place.

## **Board of Auditors**

### ***Tasks and role***

The Board of Auditors verifies the observance of the law and the Bylaws and verifies the observance of the best administration principles, the adequacy and reliability of corporate structures, internal audit procedures and

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accounting system, and the adequacy of instructions given by the Company to its subsidiaries. The Board of Auditors must receive timely disclosures, at least on a quarterly basis, from the Board of Directors about the company's business and significant transactions performed by the company and its subsidiaries, including potential conflict of interests issues. Auditors must inform the CONSOB of any irregularity they detect in the course of their duties. Auditors are required to attend Shareholders' Meetings, Board of Directors meetings and Executive Committee meetings.

In order to make available the broad range of information needed by the Board of Auditors to perform its control function effectively, the Procedure for Compliance with the Requirements of Article No. 150.1 of Italian Legislative Decree No. 58/1998 has been put in place, as described above.

The Board of Auditors held fifteen meetings during 2005 (some jointly with the Internal Control and Corporate Governance Committee and with an attendance rate of 96%). In addition, its members participated in the eleven meetings of the Board of Directors and periodically received the reports provided for in the aforementioned procedure.

In addition to the tasks performed while acting in lieu of the Audit Committee (see below), in 2005 the Board of Auditors carried out supervisory functions provided for under Italian law: verifying that the transactions of greatest significance for the Company's profitability, financial position and assets and liabilities conformed with the law, the bylaws and the principles of correct management; checking that transactions with related parties complied with the self-regulatory principles and procedures adopted by the Company and that they were in its interest; and checking the adequacy of the organizational structure. The Board of Auditors also monitored the adequacy of the internal control system and that of the administrative and accounting system and the latter's reliability in correctly representing transactions. Lastly, it investigated the reports it received under Article 2408 of the Italian Civil Code and the complaints submitted to it during the year (see below the description of the ad-hoc procedure it adopted to this end).

***Appointment***

Telecom Italia's Board of Auditors is composed of either five or seven regular auditors, as determined by a resolution of the shareholders meeting; two alternate auditors are also appointed. Pursuant to Article No. 17 of Telecom Italia's Bylaws the Board of Auditors is appointed by the Shareholders' Meeting through the *voto di lista* system, as described above.

The election of the Board of Auditors is governed by the same procedures used for the election of the Board of Directors as far as presentation, filing and publication of slates and choice of members drawn from slates presented by minority shareholders are concerned. Either three or five regular auditors are drawn from the so called majority list (that is a slate that obtained the majority of the votes cast by the shareholders), depending on the overall composition of five or seven members; two regular auditors are taken from the so called minority slates. One alternate auditor is drawn from the majority list and one from the slate that obtained the second largest number of votes.

In case an auditor chosen from the majority list or one of the minority lists ceases for any reason to serve in such capacity, the alternate chosen respectively from the majority list or the slate that obtained the second largest number of votes shall take his/her



place, until the next Shareholders Meeting, at which a replacement will be appointed by the shareholders.

The provision of the bylaws, according to which the Board of Auditors appoints among its members a Chairman, was superseded by Law No. 262/2005: pursuant to new Article No. 148 of the Draghi Law (as amended by the aforementioned Law No. 262/2005), the chairman of the board of auditors shall be appointed by the shareholders meeting from among the auditors elected by the minority shareholders. This provision was applied during the Shareholders Meeting of April 13, 2006, which resolved upon the renewal of the entire Board of Auditors.

Presently, the Company's auditors cannot be members of more than five Boards of Auditors of companies listed on the Italian Stock Exchange (excluding Telecom Italia and its subsidiaries). According to new article 148-bis of the Draghi Law, Consob is required to prepare regulations setting out the limits of the number of management

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and control positions that auditors of listed companies may hold. Pursuant to the relevant provision, Consob shall establish such limits taking into account the onerousness and complexity of each type of position, including in relation to the size of the company, the number and size of the firms included in the consolidation, and the extension and articulation of its organizational structure.

Auditors serve for a three-year term, may be reappointed and may be removed from their office for just cause and upon a resolution approved by the competent court.

***Audit Committee***

As described above, the Board of Auditors plays a key role in the Company's system of corporate governance. This is confirmed not only by the number of meetings in 2005 (15 meetings, of which some, as mentioned earlier, were held jointly with the Committee for Internal Control and Corporate Governance) but also by the Company's choices relating to US law.

More specifically, according to Rule 10A-3 under the 1934 Act and NYSE listing standards, the Board of Auditors has been identified to act as Telecom Italia's Audit Committee. The Board of Auditors meets the following requirements of the general exemption contained in Rule 10A-3(c)(3):

- the Board of Auditors is established pursuant to applicable Italian law and Telecom Italia's Bylaws;
- under Italian legal requirements, the Board of Auditors is separate from the Board of Directors;
- the Board of Auditors is not elected by the management of the Company and no executive officer is a member of the Board of Auditors;
- all of the members of the Board of Auditors meet specific independence requirements from the Company and its Group, the management and the auditing firm, as set forth by Italian legal provisions;
- the Board of Auditors, in accordance with and to the extent permitted by Italian law, is responsible for the appointment, retention and oversight of the work of the Company's external auditors engaged for the purpose of issuing the audit report on the annual financial statements;
- the Board of Auditors is authorized to engage independent counsel and other advisers, as it deems appropriate; and
- the Board of Auditors has adopted a complaints procedure (to become effective prior to July 31, 2005) in accordance with Rule 10A-3 of the 1934 Act.

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Our reliance on Rule 10A-3(c)(3) does not, in our opinion, materially adversely affect the ability of the Board of Auditors to act independently and to satisfy the other requirements of Rule 10A-3.

With specific reference to the pre-approval requirement of all audit and permitted non-audit services to be rendered by the auditing firm (and associated persons) to the Company and its subsidiaries, according to Section 202 of the Sarbanes-Oxley Act, Telecom Italia adopted a Group Procedure for the Appointment of Auditors in October 2003. The procedure (which is posted on the Company's website) regulates the engagement of auditing firms and persons (consulting firms, law firms, etc.) associated with the auditing firm on a continuous basis and significantly limits the power of the Board of Directors (and the management) while enhancing the control function performed by Telecom Italia's Board of Auditors. According to this procedure, as a rule, the engagement of external auditors requires a previous binding opinion by the Board of Auditors, unless the service to be rendered falls within a specified list of services, which has already been approved by the Board of Auditors (and which is subject to annual review).

In view of its responsibilities under Italian law and the obligations deriving from US law, in 2005 the Board of Auditors adopted a complaints procedure for receiving, retaining and treating the reports it receives. Such reports can be of the following kinds:

- statements of violations submitted by shareholders concerning matters deemed to be improper;
- complaints by any person, thus including non-shareholders, concerning alleged irregularities, improper facts or, more generally, any problem or issue deemed to merit investigation by the control body;

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- complaints specifically regarding accounting, internal accounting controls, or auditing matters; and
- confidential, anonymous submissions of concerns by employees of the Company or the Group regarding questionable accounting or auditing matters.

A short description of how such reports are to be submitted to the Board of Auditors/Audit Committee is available on the Company's website under Investors/Governance .

**Shareholders Meetings**

***Meetings of Ordinary Shareholders***

Holders of Ordinary Shares are entitled to attend and vote at ordinary and extraordinary shareholders meetings ( Shareholders Meetings ). At any Shareholders Meeting, each holder is entitled to cast one vote for each Ordinary Share held. Votes may be cast personally or by proxy. Holders of Ordinary Shares can also vote by mail.

Shareholders Meetings are called by the Company's Board of Directors when required by law or the shareholders or deemed necessary. A minimum of two auditors can call the Company's shareholder meetings.

Shareholders Meetings must be convened at least once a year. At these ordinary meetings, holders of Ordinary Shares (i) approve the annual accounts, (ii) appoint/revoke directors and auditors and determine their remuneration, when necessary, (iii) vote on other issues defined in the Bylaws, if any, (iv) authorize the completion of the transactions by the directors, if and when the Bylaws call for such previous authorization, it being understood that directors remain directly responsible for the transactions accomplished, (v) adopt rules of procedure for the shareholders meetings. Telecom Italia's Bylaws do not entrust to the ordinary shareholders meeting any additional responsibility according to points (iii) and (iv) above. The annual accounts of the Company are submitted for approval to the annual Shareholders Meeting, which must be convened within 120 days after the end of the financial year to which they relate or, where special circumstances make this necessary, within 180 days of the end of the fiscal year; if the meeting is called within 180 days, the directors shall give the reasons for the delay in the report on operations included in the annual report.

Extraordinary Shareholders Meetings may be called to pass upon proposed amendments to the Bylaws, capital increases, mergers, dissolutions, issuance of convertible debentures (which can also be delegated to the Board of Directors), appointment of receivers and similar extraordinary actions.

Shareholders are informed of all Shareholders Meetings to be held by publication of a notice in *Gazzetta Ufficiale* at least 30 days before the date fixed for the meeting. In the case of a Shareholders Meeting that is called at the request of the minority shareholders or a Shareholders Meeting called to approve the liquidation of the Company, the notice period is reduced to 20 days.

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The notice period is reduced to 15 days if the Company is subject to a tender offer and a Shareholders Meeting is called to consider defensive actions against such tender offer (in which case resolutions must be approved by at least 30% of the holders of the voting shares outstanding at all calls of the Shareholders Meeting). The notice must also be published in at least one national daily newspaper. The notice of a Shareholders Meeting may specify up to two meeting dates for an ordinary Shareholders Meeting and up to three meeting dates for an extraordinary Shareholders Meeting ( calls ).

An ordinary Shareholders Meeting is duly constituted on first call with the attendance of at least 50% of the outstanding Ordinary Shares, while on second call there is no quorum requirement. In either case, resolutions are approved by holders of the majority of the Ordinary Shares represented at the meeting.

Extraordinary Shareholders Meetings are duly constituted with the attendance of at least one-half or more than one-third or at least one-fifth of the company's share capital shareholders, on the first call, second call and third call, respectively. The favorable vote of at least two-thirds of the Ordinary Shares represented at the meeting is necessary for the resolution approval. Resolutions concerning capital increases with the exclusion or limitation of subscription rights must always be approved by holders of more than 50% of the shares outstanding, irrespective of the call in which the resolution is taken.

To attend any Shareholders Meeting, an ad hoc communication by the authorized intermediary must have been received by the Company at least two days before the meeting takes place. The communication procedure does

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not involve any blocking of the so called deposited shares: no transfer is required and the shares may be withdrawn at any time. In case of the shares' withdrawal, their prior deposit becomes ineffective for purposes of attending the meeting.

Special arrangements with the Depositary may be required for the beneficial owner of ADRs representing ADSs to attend Shareholders' Meetings and exercise voting rights with respect to underlying Ordinary Shares. See 10.5 Description of American Depositary Receipts' Voting of Deposited Securities .

As a rule, votes cast in the Shareholders' Meeting are open, as the minutes of the meeting are required to evidence how attending shareholders voted. Exception is provided for with reference to the election of the directors, when the votes shall always be cast by secret ballot.

Shareholders may attend the meeting by proxy using a power of attorney. Any one proxy cannot represent more than 200 shareholders. A proxy may be appointed only for one single meeting (including, however, the first, second and in case of extraordinary meetings' third call) and may be substituted only by the person expressly indicated in the form. The proxy can neither be a director, statutory auditor, employee of the company or of one of its controlled subsidiaries, nor a controlled company or the independent auditors of Telecom Italia or shareholders, directors, statutory auditors or employees of such independent auditors.

Votes by proxy may be solicited and collected for the shareholders' meetings of listed companies. Proxy solicitation provisions allow individuals (so-called consignors), to promote, through special brokers, the soliciting of votes by proxy at shareholders' meetings. The ownership including joint ownership of at least 0.5% (such reduced limit was introduced by CONSOB for Telecom Italia and other listed companies; the general ownership requirement is 1%) of the company's voting share capital (registered in the shareholders' register for at least six months) is a requisite for becoming a consignor. Soliciting brokers may be investment companies, banks, asset management companies and joint-stock companies, with soliciting votes by proxy as their only corporate object.

Shareholders' associations composed of at least 50 people, each with no more than 0.1% voting share capital, may collect proxies among their group. In order to facilitate such operation among employee shareholders, the Bylaws provides that special spaces will be made available to such shareholders' associations where information about solicitation can be made available and proxy collection operations can be carried out.

Ordinary Shareholders may also vote by mail. The vote by mail cannot be cast by proxy. The system is essentially based on the following principles: (a) the notice calling the shareholders' meetings must specify that shareholders can vote by mail and must describe the procedures they have to follow; (b) the notice must also be sent to the centralized securities depository system which will in turn distribute the notice to the depository banks; (c) shareholders wishing to vote by mail must send the company a copy of the communication issued by the depository banks certifying their shareholding and entitling them to vote and a special form (so called ballot) made available to such purpose by the issuer, which has to comply with specific CONSOB requirements; (d) such special forms are kept by the Chairman of the Board of Auditors until the votes are counted; (e) votes cast by mail must be delivered to the company at least 48 hours prior to the Shareholders' Meeting; and, finally, (f) votes cast by mail remain valid for the second and third calls of the meeting and can be revoked by a written declaration until the day before the meeting.

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The shareholders' meetings may be called when requested by shareholders representing at least 10% of a company's share capital, while action against directors, statutory auditors and general managers may be promoted by shareholders representing at least 5% of the Company's share capital. In the case the directors or in their place the statutory auditors don't call the Shareholders Meeting, the Court orders with a decree the call of the Shareholders Meeting, after having heard the directors and statutory auditors, if the refusal is unjustified. Shareholders are not allowed to present requests on topics upon which the Shareholders Meeting resolves, pursuant to Italian law, on directors' proposal or on a project basis or on their reports only.

Shareholders representing at least 2.5% of the share capital may request, within five days of the publication of the notice convening the meeting, additions to the agenda, specifying in the request the additional items they propose. Additions to the agenda may not be made for matters on which the shareholders' meeting is required by law to resolve on proposals put forward by the directors or on the basis of a plan or report by the Board of

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Directors. Notice of items added to the agenda following requests by shareholders, as above, shall be given in the same forms prescribed for the publication of the notice convening the meeting.

The Shareholders Meeting on May 6, 2004 adopted a set of Rules of Proceeding, which apply to both Ordinary and Extraordinary meetings.

***Meetings of Savings Shareholders***

Although holders of Savings Shares are not entitled to vote in meetings of holders of Ordinary Shares, they are entitled to attend special meetings of holders of Savings Shares ( Special Meetings ) and to appoint a joint representative (the Joint Representative ) to represent them, with respect to the Company.

The Joint Representative, who is appointed by the Special Meeting or, in default, by the Court, is entitled (i) to inspect certain corporate books of the Company, (ii) to attend the Shareholders Meetings and (iii) to challenge in court the resolutions adopted by such meetings. The Joint Representative is appointed for a maximum three-year term and, according to the Bylaws, is kept informed by the Company regarding corporate events that can affect the price trend of Savings Shares. The Savings Shareholders Meeting held on October 26, 2004 reappointed Mr. Carlo Pasteris as joint Representative for a three year period.

Special Meetings may be called when deemed necessary or upon request by Savings Shareholders representing at least 1% of the outstanding Savings Shares either by the Joint Representative or by the Company s Board of Directors in order to (a) appoint and revoke the Joint Representative, (b) approve the resolutions of the Shareholders Meetings that may affect the rights of Savings Shares, (c) set up an expense fund for the coverage of costs incurred in protecting rights of the Savings Shareholders, (d) negotiate possible disputes with the Company; and (e) resolve other issues relating to their position as holders of Savings Shares. To adopt resolutions related to (a), (c) and (e) above, a favorable vote of at least 20% of the Savings Shares is required at Special Meetings held on the first call, a favorable vote of at least 10% is required at Special Meetings held on the second call, and a favorable vote of at least a majority of the Savings Shares present is required at Special Meetings held on the third call. To adopt resolutions related to (b) and (d) above, a favorable vote of at least 20% of the Savings Ordinary Shares is required at all calls of the Special Meetings.

To attend any Special Meeting, an ad hoc communication by an authorized intermediary must have been received by the Company at least two days before the meeting takes place. Special arrangements with the Depositary may be required for the beneficial owner of ADRs representing Savings Share ADSs to attend Special Meetings and exercise voting rights with respect to underlying Savings Shares. See 10.5 Description of American Depositary Receipts Voting of Deposited Securities .

**Disclosure**



Transparent relations with holders of the Company's securities and, more generally, with the financial markets, and the provision of accurate, clear and complete information are standards for the conduct of the members of the governing bodies, the management and all the employees of the Telecom Italia Group.

Confidential information is managed by the director appointed for such specific purpose (currently the Chairman of the Board) on the basis of ad hoc procedures for the internal handling and disclosure to third parties of documents and information concerning the Company, with special reference to price-sensitive information.

The procedure for disclosing price-sensitive information in place in 2005 (Procedure for the Disclosure of Price-sensitive Information) was replaced pursuant to a resolution of the Board of Directors on March 7, 2006 by a more comprehensive procedure for the disclosure of inside information, which takes account of the legislation on market abuse and provides for the creation, with effect from April 1, 2006, of a register of persons with access to inside information. The adoption of the new procedure (Procedure for the management and public disclosure of inside information) was the result of the activity of the working group the Company set up to evaluate the effects of the transposition into Italian law of the EU's Market Abuse Directive.

The document (which is posted on the Company's website under Investors/Governance ) covers the handling including the public disclosure not only of inside information but also of information which could become such;

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it seeks to reconcile the fluidity of internal information processes with safeguarding information, especially as regards the give and take between the disclosure of inside information and the need to keep it confidential while it is being prepared. In this respect the procedure is an essential component of the Telecom Italia Group's system of internal control. It regulates inside information concerning Telecom Italia, its unlisted subsidiaries and the Group's listed securities and serves as a model for the similar measures that the other Group issuers of securities listed on regulated markets are required to adopt.

The Procedure for the management and public disclosure of inside information provides for:

- the requirements and responsibility for the classification of inside information;
- the manner of tracing access to inside information being prepared, with special regard to the creation of the register required by Italian law;
- the instruments and rules for safeguarding inside information in the making; and
- the operational rules for the disclosure of inside information to the market and in general for public announcements and/or communications to analysts/investors.

To this end it identifies the units of the Company's organization involved and lays down guidelines for the action to be taken in the presence of market rumors and in response to requests for information from those responsible for supervising and operating the markets (CONSOB and Borsa Italiana and the SEC and NYSE). The procedure also lays down guidelines for meetings with the financial community and the press, to ensure that information concerning the Company and the Telecom Italia Group is not disclosed selectively.

The procedure resulted from the initiative of the Disclosure Committee that the Company established in 2004 to provide assistance to the Board of Directors and top management as regards the processing and handling of data and news necessary for the correct provision of information. The main tasks of the Committee are:

- to assist the Board in the preparation of corporate communications (including preparation of the Annual Report on Form 20-F), the Senior Officers (as defined below) in the certification of the Annual Report of Form 20-F filed with the SEC in accordance with the Sarbanes-Oxley Act, and the director appointed to handle price-sensitive information;
- to ensure that corporate communications are prepared correctly with a view to their approval by the competent body;
- to monitor the application of the procedures and controls for the collection, analysis and retention of data and information for publication and filing, verify their adequacy and effectiveness and propose corrective measures;

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- to propose corrections to existing procedures and/or controls where appropriate;
- to verify the correct application and need for updating of the Procedure for communicating price-sensitive information and suggest improvements where appropriate; and
- to supervise the structure and updating of the Company's website as regards its institutional contents.

Permanent members of the Disclosure Committee are the General Counsel of the Company, the CFO, the Head of Corporate and Legal Affairs, the Head of Corporate Development and Investor Relations and the Chairman of Telecom Italia Audit and Compliance Services S.c.a.r.l.. Depending on the issue to be discussed, other managers or consultants may be summoned as either members or attendees of specific meetings.

The operating rules of the Disclosure Committee (which are posted on the Company's website under Investors/Governance), and its role too are likely to be revised in the process of adapting the Company's system of corporate governance to the requirements of the recent law on the protection of savings and the new edition of the Corporate Governance Code by Borsa Italiana.

In the meantime the preparation of the present Annual Report was governed and overviewed by the Committee, that approved a specific Procedure for the Preparation of the Telecom Italia 2005 Annual Report (Form 20-F) and put Riccardo Varetto (Head of Financial Statements Corporate Function under Finance, Administration and

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Control Department) in charge of the Secretariat for the specific document. According to the Secretariat's proposals, the Committee also updated its charter for disclosure procedures, pursuant to which the Committee supervised the overall drafting process and gathered ad-hoc representations by the individuals in charge of the relevant corporate structures (including the following officers: the Chief Financial Officers of Operations and of the Business Unit Media; the Head and the Chief Financial Officer of the Business Unit Olivetti; the Heads and Co-Head of Corporate Functions of Telecom Italia; the Heads of the various Central Functions under Finance, Administration and Control Department; the General Counsel and the person in charge of internal controls), so that the Committee's activities would assist the Chairman of the Board of Directors, the co-CEOs (the Managing Directors Carlo Orazio Buora and Riccardo Ruggiero) and the CFO as part of the process for the certification statements to be issued by the CEOs and the CFO (the Senior Officers).

The Committee reviewed the disclosure included in the layout of the document and its compliance with applicable rules, and assisted the Senior Officers in fulfilling their responsibility for oversight of the accuracy and timeliness of required disclosures. Upon completion of its activity, the Committee reported to the Senior Officers and presented the results of the activities carried out to the Board of Auditors and the Internal control and Corporate Governance Committee.

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**Exchange Controls And Other Limitations Affecting Security Holders**

**10.2 EXCHANGE CONTROLS AND OTHER LIMITATIONS AFFECTING SECURITY HOLDERS**

**Foreign Investment and Exchange Control Regulations in Italy**

There are no exchange controls in Italy. Residents of Italy may hold foreign currency and foreign securities of any kind, within and outside Italy. Non-residents may invest in Italian securities and may export cash, instruments of credit and securities, in both foreign currency and euro, representing interest, dividends, other asset distributions and the proceeds of dispositions without restriction other than those outlined below. There are no limitations on the right of non-resident or foreign beneficial owners to vote their Shares except as provided for all Telecom Italia shareholders by law. See 10.4 Description of Capital Stock Limitations on Voting and Shareholdings .

Updated reporting and record-keeping requirements are contained in recent Italian legislation which implements an EU Directive regarding the free movement of capital. Such legislation requires that transfers of cash or bearer bank or postal passbooks or bearer instruments in euro or in foreign currency, effected for whatsoever reason between different parties, shall be carried out by means of authorized intermediaries when the total amount of the value to be transferred is more than 12,500.00. The threshold referred to above also applies when there is reason to believe that several transactions, effected at different times within a certain period of time, constitute part of a single transaction, even if individually below the threshold amount specified. Whenever the execution of such transactions leads to believe that there are irregularities in their performance, such transactions shall be reported in writing to the Ufficio Italiano Cambi (the Italian Exchange Office) which shall carry out necessary checks. Credit institutions and other intermediaries effecting such transactions on behalf of residents or non-residents of Italy are required to maintain records of such transactions for ten years, which may be inspected at any time by Italian tax and judicial authorities. Non-compliance with the above may result in administrative fines or, criminal penalties, if the transactions fall within a case ruled by the criminal code. The Ufficio Italiano Cambi will maintain records relating to either persons notified of infringements or persons in whose regard a definitive sanction has been issued in its information system for a period which varies depending on the case.

Certain additional procedural requirements are imposed for tax reasons. Non-corporate residents of Italy effecting transfers to and from Italy in excess of 12,500.00 in one year must disclose them in their annual income tax returns. Non-corporate residents must also give details in their income tax returns of financial assets held outside Italy at the end of the fiscal year and of transfers in excess of 12,500.00 to, from, within and between foreign countries in connection with such assets during the fiscal year. No tax returns is required in respect of foreign investments and foreign income-earning assets that are exempt from income tax or subject to withholding tax in Italy. Such disclosure requirements do not apply (i) if the total value of the investments and assets at the end of the taxable period or the total amount of the transfers effected during the year is not greater than 12,500.00 or (ii) in respect of foreign investments, foreign assets or transfers within the EU (except for transfer from or to Italy). For corporate residents there is no requirement for such a declaration because their financial statements (on the basis of which their tax returns are prepared) already contain the information.

There can be no assurance that the present regulatory environment in or outside Italy will endure or that particular policies presently in effect will be maintained, although Italy is required to maintain certain regulations and policies by virtue of its membership in the EU and other international organizations and its adherence to various bilateral and multilateral international agreements.



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**Description Of Bylaws**

**10.3 DESCRIPTION OF BYLAWS**

***Object***

Telecom Italia s objects are described in Article No. 3 of the Bylaws. Such objects are:

- to install and operate fixed or mobile equipment and installations for the purpose of providing and operating licensed telecommunications services for public use, and to carry out the activities directly or indirectly related thereto;
- to hold interests in other businesses falling within the scope of the above stated corporate object or otherwise related thereto; and
- to control and provide the strategic, technical, administrative and financial coordination, overseeing and managing the financial activities of controlled companies and businesses, and carrying out all transactions related thereto.

***Directors***

There are no provisions in the Bylaws relating to: (1) the power of a director to vote on a proposal in which such director is materially interested, (2) the power of a director to (in the absence of an independent quorum) vote compensation to himself or any member of its body, (3) the power of a director to borrow money from the Company, (4) the retirement of a director under an age limit requirement and (5) the number of shares required for director s qualification.

For a description of a Director s power to vote on matters in which he may be materially interested, and to vote on compensation issues, please See 10.1 Corporate Governance 10.1.2 General Board of Directors Executive Directors and Activities of the Board and 10.1 Corporate Governance 10.1.2 General Board of Directors Internal Committees Remuneration Committee .

The Board of Directors grants specific positions to any of its members in compliance with the bylaws of the company; such positions include, among others, those of Chairman and Managing Director. According to Italian law the remuneration corresponding to such positions is then defined by the Board of Directors in its discretion, after acknowledging the opinion of the Board of Auditors.

There are no provisions in Italian law that govern the issue of directors borrowing money from the company and that set age or shareholding requirements for director s qualification.





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As of April 18, 2006, the full paid-in capital stock amounted to 10,673,750,069.40 and was constituted by 13,380,697,647 Ordinary Shares and 6,026,120,661 Savings Shares, each of 0.55 par value.

The Shareholders Meeting of May 26, 2003, reiterating, updating and, where necessary, renewing earlier resolutions of the Shareholders Meeting and the Board of Directors resolved to increase the share capital by up to a maximum of 624,936,779.50 (at April 18, 2006 125,798,206.05), by means of the issue of up to a maximum of 1,136,248,690 (at April 18, 2006 228,724,011) Ordinary Shares with a par value of 0.55 each to be reserved irrevocably and exclusively for the conversion of the Olivetti 1.5% 2001-2010 convertible notes with redemption premium (now Telecom Italia 1.5% 2001-2010 convertible notes with redemption premium ) convertible bonds, on the basis of 0.471553 Ordinary Shares for each bond presented for conversion.

The Shareholders Meeting of May 26, 2003 also resolved to increase the share capital by up to a maximum of 183,386,986.75 (at April 18, 2006 129,799,868.00), by means of the issue of up to a maximum of 333,430,885 (at April 18, 2006 235,999,760) Ordinary Shares with a par value of 0.55 each, divided into the following divisible tranches:

1. a tranche of up to a maximum of 37,398,868.65 (at April 18, 2006 19,425,568.80) for the exercise of the Piano di Stock Option 2000 stock options, increase to be implemented by July 30, 2008 by means of the issue of up to a maximum of 67,997,943 (at April 18, 2006 35,319,216) shares with a par value of 0.55 each, to be subscribed for at a total price of 13.815 per option held (i.e. at a price of 4.185259 for each newly-issued share);
2. a tranche of up to a maximum of 58,916,834.35 (at April 18, 2006 57,845,360.65) for the exercise of the Piano di Stock Option 2001 stock options, increase to be implemented by April 30, 2008 by means of the issue of up to a maximum of 107,121,517 (at April 18, 2006 105,173,383) shares with a par value of 0.55 each, to be subscribed for at a total price of 10.488 per option held (i.e. at a price of 3.177343 for each newly-issued share);
3. a tranche of up to a maximum of 21,422,652.90 (at April 18, 2006 17,210,733.65) for the exercise of the Piano di Stock Option Top 2002 stock options, increase to be implemented by February 28, 2010 by means of the issue of up to a maximum of 38,950,278 (at April 18, 2006 31,292,243) shares with a par value of 0.55 each, to be subscribed for at a total price of 9.203 per option held (i.e. at a price of 2.788052 for each newly-issued share); and
4. a tranche of up to a maximum of 50,268,799.90 (at April 18, 2006 35,318,204.90) for the exercise of the Piano di Stock Option 2002 stock options, increase to be implemented by March 31, 2008 for the first lot, by March 31, 2009 for the second lot and by March 31, 2010 for the third lot by means of the issue of up to a maximum of 91,397,818 (at April 18, 2006 64,214,918) shares with a par value of 0.55 each, to be subscribed for at a total price for the different options of respectively 9.665, 7.952 and 7.721 per option held (i.e. at a price for the different options of respectively 2.928015, 2.409061 and 2.339080 for each newly-issued share).

The shareholders meeting held on April 7, 2005 resolved to increase the share capital by up to a maximum of 38,655,832.60 (at April 18, 2006 31,036,236.00), by means of the issue of up to a maximum of 70,283,332 (at April 18, 2006 56,429,520) Ordinary Shares with a par value of 0.55 each, divided into the following divisible tranches:

1. a tranche of up to a maximum of 11,705,656.05 (at April 18, 2006 10,525,797.15) for the exercise of the 2000- 2002 Stock-Option Plans stock options, increase to be implemented by December 31, 2008 by means of the issue of up to 21,283,011 (at April 18, 2006 19,137,813) Telecom Italia Ordinary Shares with a par value of 0.55 each, to be subscribed for at a total price of 6.42 per option held (i.e. at a price of 3.710983 for each newly-issued share);
2. a tranche of up to a maximum of 22,150,920 (at April 18, 2006 18,754,065.00) for the exercise of the 2002-2003 Stock-Option Plans stock options, increase to be implemented by December 31, 2008 by means of the issue of up to 40,274,400 (at April 18, 2006 34,098,300) Telecom Italia Ordinary Shares with a par value of 0.55 each, to be subscribed for at a total price of 5.67 per option held (i.e. at a price of 3.277457 for each newly-issued share); and

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3. a tranche of up to a maximum of 3,192,173.05 (at April 18, 2006 1,756,373.85) for the exercise of the 2003-2005 Stock-Option Plans stock options, increase to be implemented by December 31, 2008 for the first lot, by December 31, 2009 for the second lot and by December 31, 2010 for the third lot by means of the issue of up to a maximum of 5,803,951 (at April 18, 2006 3,193,407) Telecom Italia Ordinary Shares with a par value of 0.55 each, to be subscribed for at a total price of 5.07 per option held (i.e. at a price of 2.930636 for each newly-issued share).

Telecom Italia s Extraordinary Shareholders Meeting of May 6, 2004 resolved that for five years starting from May 6, 2004 the Board of Directors may increase the share capital in one or more tranches by up to a maximum total amount of 880,000,000 by means of cash issues of up to a maximum of 1,600,000,000 Ordinary Shares, all or part of which:

- (i) to be offered with the right of pre-emption to shareholders and holders of convertible bonds; or
- (ii) to be offered for subscription to employees of Telecom Italia S.p.A. or its subsidiaries, with the exclusion of the right of pre-emption, provided such increase in capital does not exceed 1% of the capital attested at the date of the offering, pursuant to the combined effects of Article No. 2441, last paragraph, of the Civil Code and Articles No. 134(2) of Legislative Decree No. 58/1998.

Resolutions to increase the share capital adopted by the Board of Directors in exercising the powers attributed above shall set the subscription price (including any premium) and a time limit for the subscription of the shares; they may also provide, in the event that the increase approved is not fully subscribed within the time limit established for each issue, for the capital to be increased by an amount equal to the subscriptions received up to such time. Up to now, the aforementioned power has not been exercised.

Telecom Italia Extraordinary Shareholders Meeting of May 6, 2004 also resolved that the Board of Directors may issue, in one or more tranches and for up to a maximum of five years from May 6, 2004, convertible bonds up to a maximum amount of 880,000,000. Up to now, the aforementioned power has not been exercised.

***Classes of shares***

According to Italian law, Savings Shares may not be issued for an amount which, including other preferred shares, if any, exceeds one-half of the Company s share capital.

Pursuant to Telecom Italia s Bylaws any reduction in share capital made for the purpose of absorbing losses is applied to the par value of the Ordinary Shares until they have been reduced to zero and only then is the par value of the Savings Shares reduced. If, as a consequence of capital reduction, the Savings Shares exceed half of the Company s share capital, such excess must be eliminated within the following two years.

***Form and Transfer***

The Dematerialization Decree provides for the dematerialization of financial instruments publicly traded on regulated markets, including treasury bonds.

As a result, Ordinary Shares and Savings Shares must be held with Monte Titoli. Most Italian banks, brokers and securities dealers have securities accounts as participants with Monte Titoli, and beneficial owners of Ordinary Shares and Savings Shares may hold their interests through special deposit accounts with any such participant. The beneficial owners of Ordinary Shares and Savings Shares held with Monte Titoli may transfer their Ordinary Shares, collect dividends and exercise other rights with respect to those shares through such accounts. Such shares held by Monte Titoli are transferred between beneficial owners by appropriate instructions being given to the relevant participants associated with Monte Titoli to debit the account with the bank of the vendor and to credit the account with the bank of the purchaser.

Voting rights relating to Ordinary Shares and Savings Shares that have not been deposited with Monte Titoli may be exercised only by depositing them with an authorized intermediary. The Company may be requested to perform the functions of an intermediary.

Each person owning a beneficial interest in Ordinary Shares and Savings Shares held through Euroclear or Clearstream must rely on the procedures of Euroclear or Clearstream, respectively, and of institutions that have

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accounts with Euroclear or Clearstream to exercise any rights of a holder of shares. Holders may request Euroclear or Clearstream to transfer their Ordinary Shares and Savings Shares to an account of such holder with a participant of Monte Titoli, in which case such holders may transfer their shares, collect dividends and exercise other shareholder rights through that participant. Any such transfer through that participant is not subject to Italian transfer tax if non-Italian parties are involved. See 10.6 Taxation .

***Dividend Rights***

Holders of Savings Shares are entitled each year to a distribution with respect to such year's net profits in the amount of 5% of the par value of their shares. If with respect to any year a lesser amount is paid, the entitlement to payment of the shortfall is carried over for two successive years. In the event that dividends are paid to holders of Ordinary Shares, holders of Savings Shares have a preferential right to receive a dividend per share that is 2% of the par value of the Savings Shares greater than that received by holders of the Ordinary Shares.

In case the net profits are not enough, the Annual Ordinary Shareholders' meeting is allowed to satisfy the aforementioned preferential rights by distributing reserves, when available.

***Subscription Rights***

New Ordinary Shares and/or Savings Shares may be issued pursuant to a resolution of holders of Ordinary Shares at any extraordinary Shareholders' Meeting.

Pursuant to Italian law, shareholders (including holders of Savings Shares) are entitled to subscribe for new issues of Ordinary Shares and/or Savings Shares, debentures convertible into Ordinary Shares and/or Savings Shares and rights to subscribe for Ordinary Shares and/or Savings Shares in proportion to their respective shareholdings.

As a rule, subject to certain conditions principally designed to prevent dilution of the rights of shareholders, subscription rights may be waived or limited by resolution taken by an extraordinary Shareholders' Meeting by the affirmative vote of holders of more than 50% of the Ordinary Shares outstanding. This majority is required at the first, second and third call. On the other hand, according to the Bylaws the subscription rights can be excluded by the extraordinary Shareholders' Meeting in the amount of 10% of the pre-existent share capital with no special quorum requirement, on condition that the subscription price is equal to the shares market price and it is confirmed in the proper independent auditors report.

The shareholders can adopt a resolution, at an extraordinary Shareholders' Meeting, to convert available reserves into additional share capital. In such case, either the par value of all outstanding Ordinary Shares is identically raised or the Ordinary Shares resulting from the increase in share capital are allocated to the shareholders in proportion to their ownership before the increase without further contribution or payment from the shareholder.

***Liquidation Rights***

Subject to the satisfaction of all other creditors, holders of Ordinary Shares are entitled to a distribution in liquidation.

Holders of Savings Shares and preferred shares, if any, are entitled to a preferred right to distribution from liquidation up to their par value. No liquidation dividend is payable to the holders of other classes of shares until such preferential right has been satisfied in full. Thereafter, if there are surplus assets, holders of all classes of shares rank equally in the distribution of such surplus assets. Shares rank pari passu among themselves in a liquidation.

***Purchase of Ordinary Shares or Savings Shares by the Company***

The Company may purchase its own Ordinary Shares or Savings Shares subject to certain conditions and limitations. Such purchases must be authorized by a Shareholders Meeting and made only out of retained earnings or distributable reserves as shown on the most recent financial statements approved by the Shareholders Meeting. The par value of the Ordinary Shares or Savings Shares purchased by the Company,

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including the Ordinary Shares or Savings Shares, if any, held by the Company's subsidiaries, may not exceed 10% of the Company's share capital. The Company may purchase its own Ordinary Shares or Savings Shares:

- by means of a tender offer;
- on regulated markets in accordance with trading methods laid down in the market rules, that do not permit the direct matching of buy orders with predetermined sell orders;
- by means of the purchase and sale of derivative instruments traded on regulated markets that provide for the delivery of the underlying shares, provided the market rules lay down methods for the purchase and sale of such instruments that (i) do not permit the direct matching of buy orders with predetermined sell orders and (ii) ensure the easy participation of investors in the trading of such derivative instruments used for buybacks; and
- by granting shareholders, in relation to the shares they hold, a put option to be exercised within a period established by the shareholders' meeting authorizing the share purchase programme.

Before entering into transactions aimed at the purchase of its own shares other than by means of a tender offer (which in Italy is governed by specific disclosure requirements), the Company must disclose to the public all the details of the share purchase programme.

Ordinary Shares or Savings Shares purchased and held by the Company or one of its subsidiaries may be disposed of only pursuant to a resolution of the Company's or, if applicable, its subsidiary's shareholders' meeting.

As a rule, neither the Company nor any company under its control may vote or subscribe for new Ordinary Shares or Savings Shares of the Company, but the shareholders' meeting may authorize the exercise of subscription rights. If no such authorization is granted, the subscription rights accrue to the other holders so long as such Ordinary Shares or Savings Shares are held by the Company or a company under its control. The Ordinary Shares or the Savings Shares, as long as they are owned by the Company, are not entitled to receive dividends.

As of May 10, 2006, Telecom Italia owns 1,272,014 of its own Ordinary Shares.

The Shareholders' Meeting of April 13, 2006 authorized, for a period of 18 months from the date of the resolution, the purchase, on one or more occasions and at any time, in any of the ways permitted by the applicable rules and regulations, at the Board's discretion, of Ordinary and/or Savings shares up to the limits established by law and in any case with a limit of 1,000,000,000 on the amount that can be spent. According to the resolution the purchase price must lie between a minimum and a maximum corresponding to the weighted average of the official prices of shares of the same class recorded by Borsa Italiana on the ten trading days prior to the date of the purchase or of the determination of the purchase price, respectively reduced and augmented by 20%.

The Shareholders Meeting simultaneously authorized, for the same period of time, the disposal, on one or more occasions and at any time, of all or some of the shares repurchased by the Company, including of treasury shares already held by Telecom Italia when the resolution was taken.

***Reporting Requirements and Restrictions on Acquisitions of Shares***

Pursuant to Italian securities regulations any acquisition or sale of an interest in excess of 2%, 5%, 7.5%, 10% and all higher multiples of five, in the voting shares of a listed company, must be notified to the listed company and to CONSOB within five trading days (defined as days on which Borsa Italiana is open) following the acquisition or sale. CONSOB must make such information public within three trading days from the notification.

For purposes of the disclosure requirements referred above: (i) a person's holding must include both the shares owned by such person, even if the voting rights belong or are assigned to third parties, and the shares whose voting rights belong or are assigned to such person; (ii) a person's holding shall also include both the shares owned by nominees, trustees or subsidiary companies and the shares of which the voting rights belong or are assigned to such persons; (iii) shares registered in the names of or endorsed to trustees and those whose voting rights are assigned to an intermediary in connection with collective or individual portfolio management services are not to be attributed to the persons controlling the trustee or the intermediary.



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For the purposes of the disclosure requirements for 5%, 10%, 25% 50% and 75% thresholds, the calculation of holdings shall also include issued and subscribed shares that a person may buy or sell on his own initiative, either directly or through nominees, trustees or subsidiary companies. Shares that may be acquired by exercising conversion rights or warrants shall be included in the calculation only if the acquisition can be made within sixty days.

Shareholder agreements concerning the voting shares of a listed company must be notified to CONSOB, published in abridged form in the daily press and filed with the Company Register of the place where the company has its registered office if they provide for duties of consultation before voting, set limits on the transfer or provide for the purchase of the relevant shares, have as their object or effect the exercise of a dominant influence on the company. The same rule applies when the shareholder agreements concern the shares issued by a non-listed company that controls a listed company. The notification must include the share ownership of all parties filing it.

When listed companies change their share capital, they must notify CONSOB and Borsa Italiana of the amount of the share capital and the number and classes of shares into which it is divided. CONSOB and Borsa Italiana must make the information available to the public no later than the day following the notification. The notification shall be made no later than the day following the event causing such modification or the day following the filing of the amended bylaws.

Any holdings by a listed company of an interest in excess of 10% in the voting shares of an unlisted company must be notified to CONSOB and to the company. The reduction of the participation within the 10% threshold must be notified to the company only. Notifications to CONSOB must be made within 30 days from the approval by the Board of Directors of the half-year and the annual reports; notifications to the company whose shares are being acquired or sold must be made within seven days from the transaction which results in exceeding or going within the 10% threshold. Such information must be made public when the half-year and the annual reports are deposited. For purposes of calculating the interest threshold above, the following unlisted companies shares must be taken into account: (i) shares owned by a listed company even if the voting rights belong to a third party; and (ii) shares attributing voting rights to a listed company if such voting rights grant the listed company dominant or significant voting powers.

In accordance with Italian antitrust laws and regulations, the Antitrust Authority is required to prohibit acquisitions of sole or joint control over a company that would create or strengthen a dominant position in the domestic market or a significant part thereof. However, if the acquiring party and the company to be acquired operate in more than one Member State of the EU and exceed certain revenue thresholds, the antitrust approval of the acquisition falls within the exclusive jurisdiction of the European Commission. See Item 4. Information on the Telecom Italia Group 4.3 Regulation 4.3.8 Competition Law .

***Limitations on Voting and Shareholdings***

There are no limitations imposed by Italian law or by the Bylaws of Telecom Italia on the rights of non-residents of Italy or foreign persons to hold or vote the Shares other than those limitations resulting from the special powers of the State, which apply equally to all owners of Shares, Italian and foreign alike.



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Following the Merger, Olivetti as the surviving company changed its name to Telecom Italia S.p.A. , succeeded to the Exchange Act registration of Old Telecom Italia and became subject to the foreign private issuer reporting requirements of the Exchange Act. New Telecom Italia has completed the listing of its Ordinary Share American Depositary Shares and Savings Share American Depositary Shares on the New York Stock Exchange. New Telecom Italia has entered into two Deposit Agreements among the Company, JPMorgan Chase Bank, as depositary, and the registered Holders from time to time of ADRs issued thereunder. The first such Deposit Agreement, dated as of July 17, 2003, provides for the deposit of Ordinary Shares in registered form, par value 0.55 each and the issuance of the Ordinary Share ADSs; the second such Deposit Agreement, also dated as of July 17, 2003 provides for the deposit of Savings Shares in registered form, par value 0.55 each and the issuance of the Savings Share ADSs. Because these agreements are otherwise substantially identical, such agreements (including all exhibits and amendments thereto) are referred to herein as the Deposit Agreement , deposited Shares as well as deposited Savings Shares are referred to as Shares , and the Ordinary Share ADSs or Savings Share ADSs, as the case may be, are referred to as the ADSs . The following is a summary of the material provisions of the Deposit Agreement. This summary does not purport to be complete and is qualified in its entirety by reference to the Deposit Agreement. Copies of the Deposit Agreement are available for inspection at the principal office of the Depositary in New York (the Principal New York Office ), which is presently located at 4 New York Plaza, New York, New York 10004. Terms used herein and not otherwise defined shall have the respective meanings set forth in the Deposit Agreement.

ADRs evidencing ADSs are issuable by the Depositary pursuant to the terms of the Deposit Agreement. Each ADS represents, as of the date hereof, the right to receive 10 Ordinary Shares (in the case of each Ordinary Share ADS) or 10 Savings Shares (in the case of each Savings Share ADS) in each case deposited under the Deposit Agreement (together with any additional Ordinary Shares deposited thereunder and all other securities, property and cash received and held thereunder at any time in respect of or in lieu of such deposited Ordinary Shares, the Deposited Securities ) with the Custodian, currently the Milan office of BNP Paribas (together with any successor or successors thereto, the Custodian ). An ADR may evidence any number of ADSs. Only persons in whose names ADRs are registered on the books of the Depositary will be treated by the Depositary and the Company as Holders.

**Deposit, Issuance, Transfer and Withdrawal**

In connection with the deposit of Ordinary Shares under the Deposit Agreement, the Depositary or the Custodian may require the following in form satisfactory to it: (a) a written order directing the Depositary to issue or execute and deliver to, or upon the written order of, the person or persons designated in such order an ADR or ADRs evidencing the number of ADSs representing such Deposited Securities (a Delivery Order ); (b) proper endorsements or duly executed instruments of transfer in respect of such Deposited Securities; and (c) instruments assigning to the Custodian or its nominee any distribution on or in respect of such Deposited Securities until the Ordinary Shares are registered in the name required by the Depositary or indemnity therefor. As soon as practicable after the Custodian receives Deposited Securities pursuant to any such deposit or pursuant to any distribution upon Deposited Securities or change affecting Deposited Securities, the Custodian shall present such Deposited Securities for registration of transfer into the name of the Custodian or its nominee, to the extent such registration is practicable, at the cost and expense of the person making such deposit (or for whose benefit such deposit is made) and shall obtain evidence satisfactory to it of such registration. Deposited Securities shall be held by the Custodian for the account and to the order of the Depositary at such place or places and in such manner as the Depositary shall determine. The Depositary agrees to instruct the Custodian to place all Ordinary Shares accepted for deposit into a segregated account separate from any Ordinary Shares of the Company that may be held by such Custodian under any other depositary receipt facility relating to the Ordinary Shares. Deposited Securities may be delivered by the Custodian to any person only under the circumstances expressly contemplated in the Deposit Agreement. To the extent that the provisions of or governing the Shares make delivery of certificates therefor impracticable, Ordinary Shares may be deposited by such delivery thereof as the Depositary or the Custodian may reasonably accept, including, without limitation, by causing them to be credited to an account maintained by the Custodian for such purpose with the Company or an accredited

intermediary, such as a bank, acting as a registrar for the Ordinary Shares, together with delivery of the documents, payments and Delivery Order referred to herein to the Custodian or the Depositary. Neither the Depositary nor the Custodian shall lend Deposited Securities.

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After any such deposit of Ordinary Shares, the Custodian shall notify the Depositary of such deposit and of the information contained in any related Delivery Order by letter, first class airmail postage prepaid, or, at the request, risk and expense of the person making the deposit, by cable, telex or facsimile transmission. After receiving such notice from the Custodian (or such other evidence as the Company may accept), the Depositary, subject to the Deposit Agreement, shall properly issue or execute and deliver, as the case may be at the transfer office of the Depositary (the Transfer Office), to or upon the order of any person named in such notice, an ADR or ADRs registered as requested and evidencing the aggregate ADSs to which such person is entitled. ADSs may be issued in certificated form or through the direct registration system utilized by the Depositary pursuant to which the Depositary may record the ownership of ADRs without the issuance of a certificate, which ownership shall be evidenced by periodic statements issued by the Depositary to the Holders entitled thereto.

Subject to the terms of the Deposit Agreement, the Depositary may so issue ADRs for delivery at the Transfer Office only against deposit with the Custodian of: (a) Ordinary Shares in form satisfactory to the Custodian; (b) rights to receive Ordinary Shares from the Company or any registrar, transfer agent, clearing agent or other entity recording Share ownership or transactions; or (c) other rights to receive Shares (until such Shares are actually deposited pursuant to (a) or (b) above, Pre-released ADRs) only if (i) Pre-released ADRs are fully collateralized (marked to market daily) with cash or U.S. government securities held by the Depositary for the benefit of Holders (but such collateral shall not constitute Deposited Securities), (ii) each recipient of Pre-released ADRs agrees in writing with the Depositary that such recipient (a) owns such Shares, (b) assigns all beneficial right, title and interest therein to the Depositary, (c) holds such Shares for the account of the Depositary and (d) will deliver such Shares to the Custodian as soon as practicable and promptly upon demand therefore and (iii) all Pre-released ADRs evidence not more than 20% of all ADSs (excluding those evidenced by Pre-released ADRs provided); however, that the Depositary reserves the right to change or disregard such limit from time to time as it deems appropriate. The Depositary may retain for its own account any earnings on collateral for Pre-released ADRs and its charges for issuance thereof. At the request, risk and expense of the person depositing Shares, the Depositary may accept deposits for forwarding to the Custodian and may deliver ADRs at a place other than its office. Shares or evidence of rights to receive Shares may be deposited through (x) electronic transfer of such Shares to the account maintained by the Custodian for such purpose at Monte Titoli S.p.A., (y) evidence satisfactory to the Custodian of irrevocable instructions to cause such Shares to be transferred to such account or (z) delivery of the certificates representing such Shares. If use of the Monte Titoli book-entry system in connection with the Shares is discontinued at any time for any reason, the Company shall make other book-entry arrangements (if any) that it determines, after consultation with the Depositary, are reasonable. Every person depositing Shares under the Deposit Agreement represents and warrants that such Shares are validly issued and outstanding, fully paid, nonassessable and free of pre-emptive rights, that the person making such deposit is duly authorized so to do and that such Shares (A) are not restricted securities as such term is defined in Rule 144 under the Securities Act of 1933 unless at the time of deposit they may be freely transferred in accordance with Rule 144(k) and may otherwise be offered and sold freely in the United States or (B) have been registered under the Securities Act of 1933. Such representations and warranties shall survive the deposit of Shares and issuance of ADRs.

Subject to the terms and conditions of the Deposit Agreement, upon surrender of (i) a certificated ADR in form satisfactory to the Depositary at the Transfer Office or (ii) proper instructions and documentation in the case of a Direct Registration ADR, the Holder is entitled to delivery at the Custodian's office of the Deposited Securities at the time represented by the ADSs evidenced thereby. At the request, risk and expense of the Holder of an ADR, the Depositary may deliver such Deposited Securities at such other place as may have been requested by the Holder.

**Distributions on Deposited Securities**

Subject to the terms and conditions of the Deposit Agreement, to the extent practicable, the Depositary will distribute to each Holder entitled thereto on the record date set by the Depositary therefore at such Holder's address shown on the ADR Register, in proportion to the number of Deposited Securities (on which the following distributions on Deposited Securities are received by the

Custodian) represented by ADSs evidenced by such Holder s ADRs:

(a) *Cash.* Any U.S. dollars available to the Depositary resulting from a cash dividend or other cash distribution or authorized portion thereof ( Cash ), on an averaged, if possible, or other practicable basis, subject to appropriate

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adjustments for (i) appropriate adjustments for taxes withheld, (ii) such distribution being impermissible or impracticable with respect to certain Holders, and (iii) deduction of the Depositary's expenses in (1) converting any foreign currency to U.S. Dollars by sale or in such other manner as the Depositary may determine to the extent that it determines that such conversion may be made on a reasonable basis, (2) transferring foreign currency or U.S. Dollars to the United States by such means as the Depositary may determine to the extent that it determines that such transfer may be made on a reasonable basis, (3) obtaining any approval or license of any governmental authority required for such conversion or transfer, which is obtainable at a reasonable cost and within a reasonable time and (4) making any sale by public or private means in any commercially reasonable manner.

*(b) Shares.* (i) Additional ADRs evidencing whole ADSs representing any Shares available to the Depositary resulting from a dividend or free distribution on Deposited Securities consisting of Shares (a Share Distribution ) and (ii) U.S. Dollars available to it resulting from the net proceeds of sales of Shares received in a Share Distribution, which Shares would give rise to fractional ADSs if additional ADRs were issued therefore, as in the case of Cash.

*(c) Rights.* (i) Warrants or other instruments in the discretion of the Depositary after consultation with the Company, to the extent practicable, representing rights to acquire additional ADRs in respect of any rights to subscribe for additional Shares or rights of any nature available to the Depositary as a result of a distribution on Deposited Securities ( Rights ), to the extent that the Company timely furnishes to the Depositary evidence satisfactory to the Depositary that the Depositary may lawfully distribute the same (the Company has no obligation to so furnish such evidence), or (ii) to the extent the Company does not so furnish such evidence and sales of Rights are practicable, any U.S. Dollars available to the Depositary from the net proceeds of sales of Rights as in the case of Cash, or (iii) to the extent the Company does not so furnish such evidence and such sales cannot practicably be accomplished by reason of the non-transferability of the Rights, limited markets therefore, their short duration or otherwise, nothing (and any Rights may lapse).

*(d) Other Distributions.* (i) Securities or property available to the Depositary resulting from any distribution on Deposited Securities other than Cash, Share Distributions and Rights ( Other Distributions ), by any means that the Depositary may deem equitable and practicable, or (ii) to the extent the Depositary deems distribution of such securities or property not to be equitable and practicable, any U.S. Dollars available to the Depositary from the net proceeds of sales of Other Distributions as in the case of Cash. Such U.S. Dollars available will be distributed by checks drawn on a bank in the United States for whole dollars and cents (any fractional cents being withheld without liability for interest and added to future Cash distributions).

To the extent that the Depositary determines in its discretion that any distribution is not practicable with respect to any Holder, the Depositary, after consultation with the Company, may make such distribution as it so deems practicable, including the distribution of foreign currency, securities or property (or appropriate documents evidencing the right to receive foreign currency, securities or property) or the retention thereof as Deposited Securities with respect to such Holder's ADRs (without liability for interest thereon or the investment thereof).

There can be no assurance that the Depositary will be able to effect any currency conversion or to sell or otherwise dispose of any distributed or offered property, subscription or other rights, Shares or other securities in a timely manner or at a specified rate or price, as the case may be.

**Disclosure of Interests**

To the extent that the provisions of or governing any Deposited Securities may require disclosure of or impose limits on beneficial or other ownership of Deposited Securities, other Shares and other securities and may provide for blocking transfer, voting or other rights to enforce such disclosure or limits, Holders and all persons holding ADRs agree to comply with all such disclosure requirements and ownership limitations and to cooperate with the Depositary in the Depositary's compliance with any Company instructions in respect thereof, and the Depositary will use reasonable efforts to comply with such Company instructions.

**Record Dates**

The Depositary shall, to the extent necessary, after consultation with the Company, if practicable, fix a record date (which shall be as near as practicable to any corresponding record date set by the Company) for the



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determination of the Holders who shall be entitled to receive any distribution on or in respect of Deposited Securities, to give instructions for the exercise of any voting rights, to receive any notice or to act in respect of other matters and only such Holders at the close of business on such record date shall be so entitled.

**Voting of Deposited Securities**

Upon receipt of notice of any meeting or solicitation of consents or proxies of holders of Shares the Depositary will, unless otherwise instructed by the Company, promptly thereafter, distribute to all Holders a notice containing (i) the information (or a summary thereof) included in any such notice received by the Depositary, including the agenda for the meeting, (ii) a statement that the Holders as of the close of business on a specified record date will be entitled, subject to applicable provisions of Italian law and of the Company's Certificate of Incorporation and Bylaws (any such provisions, if material, will be summarized in such notice), to instruct the Depositary as to the exercise of voting rights, if any (subject to compliance by such Holder with the requirements described below) pertaining to the number of Shares represented by their respective ADSs, (iii) if applicable, a statement as to the manner in which such Holders may request a proper communication to the issuer attesting that beneficial ownership of the related Shares is in the name of the Holders and therefore enabling them to exercise voting rights with respect to the Shares represented by their ADSs without the use of ADS proxy cards, (iv) if applicable, an ADS proxy card pursuant to which such Holder may appoint the Depositary (with power of substitution) as his or her proxy to vote at such meeting in accordance with the directions set out in such ADS proxy card, and (v) such other information, including any such modification to the foregoing procedures as agreed between the Depositary and the Company.

Upon receipt by the Depositary of a properly completed ADS proxy card, on or before the date set by the Depositary for such purpose, the Depositary will attempt, insofar as practicable and permitted under any applicable provisions of Italian law and the Company's Certificate of Incorporation and Bylaws, to vote or cause to be voted the Shares underlying such ADRs in accordance with any nondiscretionary instructions set forth in such ADS proxy card. The Depositary will not vote or attempt to exercise the right to vote that attaches to Shares underlying such ADRs other than in accordance with such instructions.

A Holder desiring to exercise voting rights with respect to the Shares represented by its ADSs without the use of an ADS proxy card may do so by (A) depositing its ADRs in a blocked account with the Depositary until the completion of such meeting and (B) instructing the Depositary to (x) furnish the Custodian with the name and address of such Holder, the number of ADSs represented by ADRs held by such Holder and any other information required in accordance with Italian law or the Company's Certificate of Incorporation and Bylaws, (y) notify the Custodian of such deposit, and (z) instruct the Custodian to issue a communication for such meeting, which gives notice to the Company of such Holder's intention to vote the Shares underlying its ADRs. By giving the instructions set forth under point (B) above, Holders will be deemed to have authorized the Custodian to prohibit any transfers of the related Shares for the blocked period.

A precondition for the issue of the communication for a specific meeting by the Custodian may be that beneficial ownership of the related Shares has been in the name of the Holder for a specific number of days prior to the date of the meeting according to applicable provisions (if any) of Italian laws and regulations and/or applicable provisions (if any) of the Company's Certificate of Incorporation and Bylaws.

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Under Italian law, shareholders at shareholders meetings may modify the resolutions presented for their approval by the Board of Directors. In such case Holders who have given prior instructions to vote on such resolutions, and whose instructions do not provide for the case of amendments or additions to such resolutions, will be deemed to have elected to have abstained from voting on any such revised resolution.

When the Company makes its annual accounts available at its offices in connection with a general meeting of shareholders at which a vote will be taken on such accounts, the Company will deliver to the Depositary and the Custodian copies of such accounts. Until such meeting, the Depositary will make available copies of such accounts for inspection at the office of the Depositary in New York (the Transfer Office ), the office of the Custodian in Milan, Italy and any other designated transfer offices.

In the Deposit Agreement, the Depositary and the Company agree to use reasonable efforts to make and maintain arrangements (in addition to or in substitution of the arrangements described in this paragraph) to enable Holders to vote the Shares underlying their ADRs.

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#### **Inspection of Transfer Books**

The Deposit Agreement provides that the Depositary or its agent will keep books at its Transfer Office for the registration, registration of transfer, combination and split-up of ADRs, and, in the case of Direct Registration ADRs, shall include the Direct Registration System which at all reasonable times will be open for inspection by the Holders and the Company for the purpose of communicating with Holders in the interest of the business of the Company or a matter relating to the Deposit Agreement.

#### **Reports and Other Communications**

The Deposit Agreement, the provisions of or governing Deposited Securities and any written communications from the Company, which are both received by the Custodian or its nominee as a holder of Deposited Securities and made generally available to the holders of Deposited Securities, are available for inspection by Holders at the offices of the Depositary and the Custodian and at the Transfer Office. The Depositary will mail copies of such communications (or English translations or summaries thereof) to Holders when furnished by the Company.

On or before the first date on which the Company makes any communication generally available to holders of Deposited Securities or any securities regulatory authority or stock exchange, by publication or otherwise, the Company shall transmit to the Depositary a copy thereof in English or with an English translation or summary. The Company has delivered to the Depositary and the Custodian, a copy of all provisions of or governing the Shares (other than copies of Italian law) and any other Deposited Securities issued by the Company or any affiliate of the Company, if any, and, promptly upon any change thereto, the Company shall deliver to the Depositary and Custodian, a copy (in English or with an English translation) of such provisions (other than copies of Italian law) as so changed.

#### **Changes Affecting Deposited Securities**

Subject to the terms of the Deposit Agreement and the ADRs, the Depositary may, in its discretion, amend the ADRs or distribute additional or amended ADRs (with or without calling ADRs for exchange) or cash, securities or property on the record date set by the Depositary therefore to reflect any change in par value, split-up, consolidation, cancellation or other reclassification of Deposited Securities, any Share Distribution or Other Distribution not distributed to Holders or any cash, securities or property available to the Depositary in respect of Deposited Securities from (and the Depositary is hereby authorized to surrender any Deposited Securities to any person and to sell by public or private sale any property received in connection with) any recapitalization, reorganization, merger, consolidation, liquidation, receivership, bankruptcy or sale of all or substantially all the assets of the Company, and to the extent the Depositary does not so amend the ADRs or make a distribution to Holders to reflect any of the foregoing, or the net proceeds thereof, whatever cash, securities or property results from any of the foregoing shall constitute Deposited Securities and each ADS evidenced by ADRs shall automatically represent its pro rata interest in the Deposited Securities as then constituted.

#### **Amendment and Termination of Deposit Agreement**

The ADRs and the Deposit Agreement may be amended by the Company and the Depositary, provided that any amendment that imposes or increases any fees or charges (other than stock transfer or other taxes and other governmental charges, transfer or registration fees, cable, telex or facsimile transmission costs, delivery costs or other such expenses), or that shall otherwise prejudice any substantial existing right of Holders, shall become effective 30 days after notice of such amendment shall have been given to the Holders. Every Holder of an ADR at the time any amendment to the Deposit Agreement so becomes effective shall be deemed, by continuing to hold such ADR, to consent and agree to such amendment and to be bound by the Deposit Agreement and the ADRs as amended thereby. In no event shall any amendment impair the right of the Holder of any ADR to surrender such ADR and receive the Deposited Securities represented thereby, except in order to comply with mandatory provisions of applicable law. Any amendments or supplements which (i) are reasonably necessary (as agreed by the Company and the Depositary) in order for (a) the ADSs to be registered on Form F-6 under the Securities Act of 1933 or (b) the ADSs or Shares to be traded solely in electronic book-entry form and (ii) do not in either such case impose or increase any fees or charges to be borne by Holders, shall be deemed not to prejudice any substantial rights of Holders. Notwithstanding the foregoing, if any governmental body should adopt new laws, rules or regulations which would require amendment or supplement of the Deposit Agreement or the form of

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ADR to ensure compliance therewith, the Company and the Depositary may amend or supplement the Deposit Agreement and the ADR at any time in accordance with such changed rules. Such amendment or supplement to the Deposit Agreement in such circumstances may become effective before a notice of such amendment or supplement is given to Holders or within any other period of time as required for compliance.

Upon any resignation of the Depositary which does not become effective during the earlier of (i) 90 days from the date of the Depositary shall have resigned as such and (ii) the date on which the Company shall have appointed a successor depositary or on any removal of the Depositary pursuant to the Deposit Agreement, the Depositary may, and shall at the written direction of the Company, terminate the Deposit Agreement and this ADR by mailing notice of such termination to the Holders at least 30 days prior to the date fixed in such notice for such termination. After the date so fixed for termination, the Depositary and its agents will perform no further acts under the Deposit Agreement and this ADR, except to receive and hold (or sell) distributions on Deposited Securities and deliver Deposited Securities being withdrawn. As soon as practicable after the expiration of six months from the date so fixed for termination, the Depositary shall sell the Deposited Securities and shall thereafter (as long as it may lawfully do so) hold in a segregated account the net proceeds of such sales, together with any other cash then held by it under the Deposit Agreement, without liability for interest, in trust for the pro rata benefit of the Holders of ADRs not theretofore surrendered. After making such sale, the Depositary shall be discharged from all obligations in respect of the Deposit Agreement and this ADR, except to account for such net proceeds and other cash. After the date so fixed for termination, the Company shall be discharged from all obligations under the Deposit Agreement except for its obligations to the Depositary and its agents.

**Charges of Depositary**

The Depositary may charge each person to whom ADSs are issued against deposits of Shares, including deposits in respect of Share Distributions, Rights and Other Distributions, and each person surrendering ADSs for withdrawal of Deposited Securities, U.S.\$5.00 for each 100 ADSs (or portion thereof) delivered or surrendered. The Depositary may sell (by public or private sale) sufficient securities and property received in respect of Share Distributions, Rights and Other Distributions prior to such deposit to pay such charge. In addition, the Depositary may charge Holders, a fee for the distribution of securities, such fee being in an amount equal to the fee for the execution and delivery of ADSs referred to above which would have been charged as a result of the deposit of such securities (for purposes hereof treating all such securities as if they were Shares) but which securities or the net cash proceeds from the sale thereof are instead distributed by the Depositary to Holders entitled thereto. The Company will pay all other charges and expenses of the Depositary and any agent of the Depositary (except the Custodian) pursuant to agreements from time to time between the Company and the Depositary, except (i) stock transfer or other taxes and other governmental charges (which are payable by Holders or persons depositing Shares), (ii) cable, telex and facsimile transmission and delivery charges incurred at the request of persons depositing, or Holders delivering Shares, ADRs or Deposited Securities (which are payable by such persons or Holders), (iii) transfer or registration fees for the registration of transfer of Deposited Securities on any applicable register in connection with the deposit or withdrawal of Deposited Securities (which are payable by persons depositing Shares or Holders withdrawing Deposited Securities; there are no such fees in respect of the Shares as of the date of the Deposit Agreement), (iv) expenses of the Depositary in connection with the conversion of foreign currency into U.S. dollars (which are paid out of such foreign currency) and (v) such fees and expenses as are incurred by the Depositary (including without limitation expenses incurred on behalf of Holders in connection with compliance with foreign exchange control regulations or any law or regulation relating to foreign investment) in delivery of Deposited Securities or otherwise in connection with the Depositary's or its Custodian's compliance with applicable law, rule or regulation.

**Liability of Holders for Taxes**

If any tax or other governmental charge shall become payable by or on behalf of the Custodian or the Depositary with respect to an ADR, any Deposited Securities represented by the ADSs evidenced thereby or any distribution thereon, such tax or other governmental charge shall be paid by the Holder thereof to the Depositary. The Depositary may refuse to effect any registration, registration of transfer, split-up or combination or, only for those reasons set forth in General Instruction I.A.(1) of Form F-6 under the Securities Act, any withdrawal of Deposited Securities until such payment is made. The Depositary may also deduct from any distributions on or in respect of Deposited Securities, or may sell by public or private sale for the account of the respective Holder any part or all of such Deposited Securities (after attempting by reasonable means to notify the Holder thereof prior to such

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sale), and may apply such deduction or the proceeds of any such sale in payment of such tax or other governmental charge, the respective Holder remaining liable for any deficiency, and shall reduce the number of ADSs evidenced thereby to reflect any such sales of Shares.

In connection with any distribution to Holders, the Company or its agents will remit to the appropriate governmental authority or agency all amounts (if any) required to be withheld and owing to such authority or agency by the Company or its agents; and the Depositary and the Custodian will remit to the appropriate governmental authority or agency all amounts (if any) required to be withheld by the Depositary or the Custodian. The Depositary shall forward to the Company or its agent such information from its records as the Company may request to enable the Company or its agent to file necessary reports with governmental authorities or agencies. If the Depositary determines that any distribution in property other than cash (including Shares or rights) on Deposited Securities is subject to any tax that the Depositary or the Custodian is obligated to withhold, the Depositary may dispose of all or a portion of such property in such amounts and in such manner as the Depositary deems necessary and practicable to pay such taxes, by public or private sale, and the Depositary shall distribute the net proceeds of any such sale or the balance of any such property after deduction of such taxes to the Holders entitled thereto.

The Depositary and the Company agree to use reasonable efforts to make and maintain arrangements (in addition to or in substitution of the arrangements described herein) to enable persons that are considered United States residents for purposes of applicable law to receive any rebates, tax credits or other benefits (pursuant to treaty or otherwise) relating to distributions on the ADSs to which such persons are entitled. Notwithstanding the above, the Company may, by written notice to the Depositary, modify or withdraw the procedures described in this paragraph (including by ceasing to pay to the Depositary any amounts in respect of refunds of Italian withholding taxes), to the extent the Company determines that its participation in the refund process is no longer lawful or practical.

See 10.6 Taxation for additional information on tax issues relating to ADRs.

**General Limitations**

The Depositary, the Company, their agents and each of them shall: (a) incur no liability (i) if any present or future law, regulation, the provisions of or governing any Deposited Securities, act of God, war or other circumstance beyond its control shall prevent, delay or subject to any civil or criminal penalty any act which the Deposit Agreement or this ADR provides shall be done or performed by it, or (ii) by reason of any exercise or failure to exercise any discretion given it in the Deposit Agreement or this ADR; (b) assume no liability except to perform its obligations to the extent they are specifically set forth in this ADR and the Deposit Agreement without gross negligence or bad faith; (c) in the case of the Depositary and its agents, be under no obligation to appear in, prosecute or defend any action, suit or other proceeding in respect of any Deposited Securities or this ADR; (d) in the case of the Company and its agents hereunder be under no obligation to appear in, prosecute or defend any action, suit or other proceeding in respect of any Deposited Securities or this ADR, which in its opinion may involve it in expense or liability, unless indemnity satisfactory to it against all expense (including fees and disbursements of counsel) and liability be furnished as often as may be required; or (e) not be liable for any action or inaction by it in reliance upon the advice of or information from legal counsel, accountants, any person presenting Shares for deposit, any Holder, or any other person believed by it in good faith to be competent to give such advice or information. The Depositary, its agents and the Company may rely and shall be protected in acting upon any written notice, request, direction or other document believed by them in good faith to be genuine and to have been signed or presented by the proper party or parties. The Depositary and its agents will not be responsible for any failure to carry out any instructions to vote any of the Deposited Securities (provided that such act or omission to act is in good faith), for the manner in which any such vote is cast or for the effect of any such vote. The Depositary and its agents may own and deal in any class of

securities of the Company and its affiliates and in ADRs. Neither the Company, the Depositary nor any of their respective agents shall be liable to Holders or beneficial owners of interests in ADSs for any indirect, special, punitive or consequential damages.

Prior to the issue, registration, registration of transfer, split-up or combination of any ADR, the delivery of any distribution in respect thereof, or, subject to the last sentence of this paragraph, the withdrawal of any Deposited Securities, and from time to time, in the case of clause (b)(ii) of this paragraph, the Company, the Depositary or the Custodian may require: (a) payment with respect thereto of (i) any stock transfer or other tax or other



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governmental charge, (ii) any stock transfer or registration fees in effect for the registration of transfers of Shares or other Deposited Securities upon any applicable register and (iii) any applicable charges; (b) the production of proof satisfactory to it of (i) the identity and genuineness of any signature and (ii) such other information, including without limitation, information as to citizenship, residence, exchange control approval, beneficial ownership of any securities, compliance with applicable law, regulations, provisions of or governing Deposited Securities and terms of the Deposit Agreement and the ADRs, as it may deem necessary or proper; and (c) compliance with such regulations as the Depositary may establish consistent with the Deposit Agreement. The Depositary shall provide to the Company, promptly upon its written request, copies of any such proofs of citizenship or residence or other information referred to in (b) above so requested. The issuance of ADRs, the acceptance of deposits of Shares, the registration, registration of transfer, split-up or combination of ADRs or, subject to the last sentence of this paragraph, the withdrawal of Deposited Securities may be suspended, generally or in particular instances, when the ADR register or any register for Deposited Securities is closed or when any such action is deemed necessary or advisable by the Depositary or the Company. Notwithstanding any other provision of the Deposit Agreement or the ADRs, the withdrawal of Deposited Securities may be restricted only for the reasons set forth in General Instruction I.A.(1) of Form F-6 (as such instructions may be amended from time to time) under the Securities Act.

**Governing Law**

The Deposit Agreement is governed by and shall be construed in accordance with the laws of the State of New York.

**JPMorgan Chase Bank**

The Depositary is JPMorgan Chase Bank, N.A., a New York banking corporation, which has its principal office located in New York, New York. JPMorgan Chase Bank N.A. delivers financial information and transaction processing services to corporations, financial institutions and government entities around the world, offering a wide range of products: ADRs, cash management, treasury, custody, investor and institutional trust services.

JPMorgan Chase Bank N.A. is a commercial bank offering a wide range of banking and trust services to its customers in the New York metropolitan area, throughout the United States and around the world.

The Consolidated Balance Sheets of J.P. Morgan Chase & Co. Incorporated ( J.P. Morgan ), the parent corporation of JPMorgan Chase Bank N.A., are set forth in the most recent Annual Report and Form 10-Q. The Annual Report, Form 10-K and Form 10-Q of J.P. Morgan are on file with the SEC.

The Articles of Association of JPMorgan Chase Bank and Bylaws together with the annual report, Form 10-K and Form 10-Q of J.P. Morgan are available for inspection at the Principal New York Office of the Depositary. Information about the firm is also available at [www.jpmorganchase.com](http://www.jpmorganchase.com).



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**10.6 TAXATION**

Unless otherwise indicated, for purposes of the following discussion regarding taxation the Shares and the Savings Shares are collectively referred to as the Telecom Italia Shares .

**Italian Taxation**

The following is a summary of certain Italian tax consequences of the purchase, ownership and disposition of Shares, Savings Shares or ADRs as at the date hereof. It does not purport to be a complete analysis of all potential tax matters relevant to a decision to hold Shares, Savings Shares or ADRs. For purposes of Italian law and the Italian-U.S. Income Tax Convention (the Treaty ), holders of American Depositary Shares which are evidenced by ADRs will be treated as holders of the underlying Shares or Savings Shares, as the case may be.

***Income Tax***

Under Italian law, dividends paid to holders of Savings Shares and applicable ADRs who are not Italian residents and do not have a permanent establishment in Italy to which dividends are connected are subject to a 12.5% withholding tax.

Under Italian law, dividends paid to holders of Shares and applicable ADRs who are not Italian residents and do not have a permanent establishment in Italy to which dividends are connected are subject to a 27% withholding tax.

Under Italian law, all shares of Italian listed companies have to be registered in a centralized deposit system. With respect to dividends paid in connection with shares held in the centralized deposit system managed by Monte Titoli, such as Telecom Italia Shares, instead of the 27% or 12.5% withholding taxes mentioned above, a substitute income tax will apply at the same tax rates as the above-mentioned withholding taxes. This substitute income tax is levied by the Italian authorized intermediaries participating in the Monte Titoli system and with whom the securities are deposited and also by non-Italian authorized intermediaries participating, directly or through a non-Italian centralized deposit system, in the Monte Titoli system.

Non-resident holders of Shares and ADRs have the right to recover within 48 months from the date of payment of the Italian substitute income tax, up to four-ninths of such 27% substitute tax on their dividend income, upon providing adequate evidence, certified by the tax authorities in their home country, that they paid a corresponding amount of income tax in their home country on the same dividend income.

These refunds are normally subject to extensive delays. In addition, these refunds are an alternative to seeking any relief from double taxation under an income tax treaty, including the Treaty.

U.S. resident owners of Shares and ADRs may be entitled to a reduced tax rate on their dividends under the Treaty. Where a U.S. resident owner qualifies for the benefits of the Treaty, is the actual beneficiary of the dividends and the dividends paid are not connected with a permanent establishment in Italy through which the U.S. resident owner carries on a business or with a fixed base in Italy through which the U.S. resident owner performs independent personal services, the Treaty generally provides that Italian taxes cannot exceed 15% of the gross amount of the dividend.

To obtain the reduced tax rate afforded by the Treaty, a beneficial owner of Shares or ADRs must provide, before the dividend is paid (usually, according to the intermediary instructions), the intermediary with which the shares are deposited and which participates in the Monte Titoli system with the following:

- (i) a declaration by the beneficial owner containing all the data identifying such person as the beneficial owner and establishing the existence of all the conditions necessary for the application of the Treaty; and
- (ii) a certification (Form 6166) issued by the U.S. Internal Revenue Service that states that the beneficial owner is a U.S. resident for tax purposes. The certification is valid until March 31 of the year following the submission.

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The processing of requests for certification by the U.S. Internal Revenue Service may take a substantial period of time. Accordingly, in order to be eligible for the procedure described below, eligible ADR holders should begin the process of obtaining Form 6166 as soon as possible after receiving instructions from the Depository on how to claim the reduced rate provided by the Treaty.

The Depository's instructions, which will be sent to all ADR holders before the dividend payment date, will specify certain deadlines for delivering to the Depository of any documentation required to obtain the reduced rate provided by the Treaty, including the certification that the eligible ADR holders must obtain from the U.S. Internal Revenue Service. In the case of ADRs held through a broker or other financial intermediary, the required documentation should be delivered to such financial intermediary for transmission to the Depository. In all other cases, the eligible ADR holders should deliver the required documentation directly to the Depository.

If the holder of Shares or ADRs fails to obtain the reduced rate provided by the Treaty at the time the dividend is paid, a refund equal to the difference between the Treaty rate and the Italian 27% substitute tax, applied at the payment of dividends, may be claimed directly from the Italian tax authorities. Extensive delays have been encountered by U.S. residents seeking payments directly from the Italian authorities.

In the case of dividends derived by a U.S. partnership, the reduction of the tax rate under the Treaty is only available to the extent such dividends are subject to U.S. tax in the hands of the partners.

**Transfer Tax**

Transfer tax is not payable upon the transfer of Telecom Italia Shares or ADRs through Telematico or any other regulated financial market. Transfers of Telecom Italia Shares or ADRs which occur outside a regulated financial market are exempted from the payment of transfer tax provided that the parties entering into the agreement pursuant to which the transfer takes place are all non-residents of Italy and the relevant Telecom Italia Shares or ADRs are not deposited at an Italian intermediary. Other types of transfers of shares listed on Telematico or any other regulated financial market which occur outside a regulated financial market are also exempted from the payment of transfer tax provided that the parties entering into the agreement pursuant to which the transfer taxes take place are (i) banks, Italian securities dealing firms ( SIMs ) or exchange agents or (ii) banks, SIMs or exchange agents on the one hand, and non-residents on the other hand or (iii) banks, SIMs or resident or non-resident exchange agents, on the one hand, and investment funds on the other hand. In any other case, transfer tax is currently payable at the following rates:

- 0.072 per 51.65 (or any fraction) of the price at which the Telecom Italia Shares or ADRs are transferred when the transfer is made directly between the parties or through an intermediary that is not a bank, SIM or broker; and
- 0.0258 per 51.65 (or any fraction) of the price at which the Telecom Italia Shares or ADRs are transferred when the transfer is made either (i) between a bank, SIM or broker and a private party or (ii) between private parties through a bank, SIM or broker.

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The mere change of a depositary (e.g., Euroclear, Clearstream, Monte Titoli, DTC or the Depositary) not involving a transfer of the ownership of the transferred Telecom Italia Shares will not trigger the Italian transfer tax.

In general, with respect to U.S. holders, the transfer tax will not be applicable on transfers of Telecom Italia Shares or ADRs through regulated financial markets. However, in the case of transfers which are not executed on a regulated financial market and are entered into with an Italian counterparty other than a bank or authorized financial intermediary or an investment fund, it is advisable that U.S. holders consult their own tax advisors concerning the applicability of this transfer tax. Deposits and withdrawals of Telecom Italia Shares in return for ADRs by non-Italian residents will not be subject to the transfer tax.

### ***Capital Gains Tax***

Under Italian law, capital gains tax ( CGT ) is levied on capital gains realized by non-residents from the disposal of shares in companies resident in Italy for tax purposes even if those shares are held outside of Italy. For the purposes of CGT, the exchange of shares under a merger or de-merger of Italian companies does not constitute a disposal of shares. In such transactions, the tax value and the holding period of the exchanged shares is carried

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over to the shares received in the exchange. Capital gains realized by non-resident holders on the sale of non-qualified shareholdings (as defined below) in companies listed on a stock exchange and resident in Italy for tax purposes (as is Telecom Italia's case) are not subject to CGT.

A qualified shareholding consists of securities (except for Saving Shares and applicable ADRs) that (i) entitle the holder to exercise more than 2% of the voting rights of a company with shares listed on a stock exchange (as is Telecom Italia's case) in the ordinary meeting of the shareholders or (ii) represent more than 5% of the share capital of a company with shares listed on a stock exchange (as is Telecom Italia's case). A non-qualified shareholding is any shareholding that does not meet the above mentioned interest rights to be qualified as a qualified shareholding.

The relevant percentage is calculated taking into account the shareholdings sold during the prior 12-month period.

Pursuant to the Treaty, a U.S. resident will not be subject to Italian CGT on a sale of qualified shareholdings unless the Telecom Italia Shares or ADRs form part of the business property of a permanent establishment of the holder in Italy or pertain to a fixed base available to a holder in Italy for the purpose of performing independent personal services. U.S. residents who sell Telecom Italia Shares or ADRs may be required to produce appropriate documentation establishing that the above mentioned conditions of non-taxability pursuant to the Treaty provisions have been satisfied if CGT would otherwise be applicable.

***Inheritance and Gift Tax***

According to Law No. 383 of October 18, 2001 ( Law No. 383 ), Italian inheritance and gift tax, previously payable on transfer of securities on death or by gift, has been abolished starting from October 25, 2001.

However, for grantees other than spouses, direct descendants or ancestors and other relatives within the fourth degree, if and to the extent that the value of the gift to any such grantee exceeds 180,759.91, the gift of shares may be subject to the ordinary transfer taxes that would apply if the shares had been transferred for consideration (i.e., registration tax at the flat rate of 168.00).

Moreover, an anti-avoidance rule is provided by Law No. 383 for any gift of assets (such as shares) which, if sold for consideration, would give rise to capital gains subject to CGT. In particular, if the grantee sells shares received as a gift for consideration within 5 years from their receipt, the grantee will be required to pay the relevant CGT, where applicable, as if the gift had never taken place.

There is currently no gift tax convention between Italy and the United States.

**United States Federal Income Taxation**

The following summary describes the material U.S. federal income tax consequences of the acquisition, ownership and sale of Telecom Italia Shares, including Telecom Italia Shares represented by American Depositary Shares evidenced by ADRs, that are generally applicable to the U.S. holders described herein who own Telecom Italia Shares or ADRs as capital assets for U.S. federal income tax purposes, but it does not purport to be a comprehensive description of all of the tax considerations that may be relevant to a particular person's decision to acquire such securities. For these purposes, you are a U.S. holder if you are for U.S. federal income tax purposes:

- a citizen or resident of the United States;
- a corporation, or other entity taxable as a corporation, created or organized under the laws of the United States or of any political subdivision of the United States; or
- an estate or trust the income of which is subject to U.S. federal income taxation regardless of its source.

This discussion is based on the tax laws of the United States currently in effect, including the Internal Revenue Code of 1986, as amended, Treasury regulations, administrative announcements, and judicial decisions, as well as the Italian-U.S. income tax convention (the Treaty). These laws may change, possibly with retroactive effect. This discussion does not address U.S. state, local or non-U.S. tax consequences.



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This discussion is based in part upon representations of the Depositary and assumes that each obligation provided for in, or otherwise contemplated by, the Deposit Agreement and any related agreement will be performed in accordance with its respective terms. The U.S. Treasury has expressed concerns that parties to whom ADRs are pre-released may be taking actions that are inconsistent with the claiming, by U.S. holders of ADRs, of foreign tax credits for U.S. federal income tax purposes. Such actions would also be inconsistent with the claiming of the reduced rate of tax applicable to dividends received by certain noncorporate U.S. holders. Accordingly, the analysis of the creditability of Italian taxes by ADR holders and the availability of the reduced tax rate on dividends received by certain noncorporate U.S. holders, both discussed below, could be affected by actions that may be taken by parties to whom ADRs are pre-released.

This discussion does not address all of the tax consequences that may be relevant in light of your particular circumstances. In particular, it does not address purchasers subject to special rules, including:

- partnerships and other entities classified as partnerships for U.S. federal income tax purposes;
- persons subject to the alternative minimum tax;
- tax-exempt entities;
- dealers and traders in securities or foreign currencies;
- insurance companies;
- financial institutions;
- persons who own the Telecom Italia Shares or ADRs as part of an integrated investment, including a straddle, hedging or conversion transaction, comprised of the Telecom Italia Shares or ADRs and one or more other positions for tax purposes;
- persons whose functional currency is not the U.S. dollar for U.S. federal income tax purposes;
- persons who actually or constructively own 10% or more of the Company's voting stock; or
- persons who acquire Telecom Italia Shares or ADRs pursuant to the exercise of any employee stock option or otherwise as compensation.

Please consult your tax advisor with regard to the application of U.S. federal income tax laws to the Telecom Italia Shares or ADRs, and any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction. For U.S. federal income tax purposes, holders of ADRs evidencing American Depositary Shares will generally be treated as owners of the underlying Shares or

Savings Shares, as the case may be, represented by those American Depositary Shares. Accordingly, no gain or loss will be recognized if you exchange ADRs for the underlying shares represented by those ADRs.

This discussion assumes that the Company was not a passive foreign investment company for 2005 (as discussed below).

***Taxation of dividends***

Distributions made with respect to the Telecom Italia Shares or ADRs (other than certain pro rata distributions of Telecom Italia Shares or ADRs), including any Italian tax withheld, will generally constitute foreign source dividend income for U.S. federal income tax purposes to the extent such distributions are made from the Company's current or accumulated earnings and profits, as determined in accordance with U.S. federal income tax principles. Subject to applicable limitations that may vary depending on a U.S. holder's individual circumstances and the discussion above regarding concerns expressed by the U.S. Treasury, dividends paid to certain noncorporate U.S. holders in taxable years beginning before January 1, 2011 will be taxable at a maximum tax rate of 15%. Noncorporate U.S. holders should consult their own tax advisors to determine whether they are subject to any special rules that may limit their ability to be taxed at this favorable rate.

You will not be entitled to claim a dividends-received deduction for dividends paid on the Telecom Italia Shares or ADRs. The amount of any cash distribution paid in euros, including the amount of any Italian tax withheld, will be equal to the U.S. dollar value of such euros on the date of receipt by the Depository in the case of U.S. holders of ADRs, or by the U.S. holder in the case of U.S. holders of Telecom Italia Shares, regardless of whether the

**Table of Contents****Item 10. Additional Information****Taxation**

payment is in fact converted into U.S. dollars. Gain or loss, if any, recognized on the sale or other disposition of such euros will be U.S. source ordinary income or loss. If the dividend is converted into U.S. dollars on the date of receipt, you generally should not be required to recognize foreign currency gain or loss in respect of the dividend income. You may have foreign currency gain or loss if you do not convert the amount of such dividend into U.S. dollars on the date of its receipt. The amount of any distribution of property other than cash will be the fair market value of such property on the date of distribution.

Subject to certain limitations and restrictions and the discussion above regarding concerns expressed by the U.S. Treasury, Italian taxes withheld from distributions at a rate not in excess of that provided in the Treaty will be eligible for credit against a U.S. holder's U.S. federal income tax liability. Italian taxes withheld in excess of the rate provided in the Treaty will generally not be eligible for credit against a U.S. holder's U.S. federal income tax liability. The limitation on foreign taxes eligible for credit is calculated separately with respect to specific classes of income. Instead of claiming a credit, you may, at your election, deduct such otherwise creditable Italian taxes in computing your taxable income, subject to generally applicable limitations under U.S. law. You should consult your tax advisor concerning the foreign tax credit implications of the payment of any Italian withholding taxes.

***Taxation of capital gains***

You will generally recognize U.S. source capital gain or loss for U.S. federal income tax purposes on the sale or exchange of Telecom Italia Shares or ADRs, which will be long-term capital gain or loss if the Telecom Italia Shares or ADRs were held for more than one year. The amount of gain or loss will be equal to the difference between the amount realized and your adjusted basis in the Telecom Italia Shares or ADRs. You should consult your own tax advisor about the treatment of capital gains, which may be taxed at lower rates than ordinary income for non-corporate taxpayers, and capital losses, the deductibility of which may be limited.

***Passive Foreign Investment Company Rules***

The Company believes that it was not a passive foreign investment company ( PFIC ) for U.S. federal income tax purposes for 2005. However, since PFIC status depends upon the composition of the Company's income and assets and the market value of the Company's assets (including, among others, less than 25% owned equity investments) from time to time, there can be no assurance that the Company will not be considered a PFIC for any taxable year. If the Company were treated as a PFIC for any taxable year during which a U.S. holder held Telecom Italia Shares or ADRs, certain adverse tax consequences could apply to the U.S. holder.

***Information Reporting and Backup Withholding***

You may, under certain circumstances, be subject to information reporting and backup withholding with respect to dividends or the proceeds of any sale, exchange or redemption of ADRs or Telecom Italia Shares unless you:

- are a corporation or come within certain other exempt categories, and, when required, demonstrate this fact; or

- in the case of back up withholding, provide a correct taxpayer identification number, certify that you are not subject to backup withholding and otherwise comply with applicable requirements of the backup withholding rules.

Any amount withheld under these rules will be creditable against your U.S. federal income tax liability and may entitle you to a refund; provided that the required information is furnished to the U.S. Internal Revenue Service. If you are required to and do not provide a correct taxpayer identification number, you may be subject to penalties imposed by the U.S. Internal Revenue Service.

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**Item 11. Quantitative And Qualitative Disclosures About Market Risks**

**Item 11. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS**

See Item 5. Operating and Financial Review and Prospects 5.10 Quantitative and Qualitative Disclosures About Market Risks .

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**Item 12. Description Of Securities Other Than Equity Securities**

**Item 12. DESCRIPTION OF SECURITIES OTHER THAN EQUITY SECURITIES**

Not applicable.

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**Item 13. Defaults, Dividend Arrearages And Delinquencies**

**PART II**

**Item 13. DEFAULTS, DIVIDEND ARREARAGES AND DELINQUENCIES**

Not applicable.

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**Item 14. Material Modification to the Rights Of Security Holders And**

**Use Of Proceeds**

**Item 14. MATERIAL MODIFICATION TO THE RIGHTS OF SECURITY HOLDERS AND USE OF PROCEEDS**

Not applicable.

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**Item 15. Controls And Procedures**

**Item 15. CONTROLS AND PROCEDURES**

As of December 31, 2005, the Company, under the supervision and with the participation of the officers selected by the Disclosure Committee according to its charter for disclosure procedures (see Item 10. Additional Information 10.1 Corporate Governance 10.1.2 General Disclosure ) and Telecom Italia Audit and Compliance Services S.c.a.r.l. which assessed the effectiveness of the overall internal control system, including the Chief Executive Officers and the Chief Financial Officer, performed an evaluation of the effectiveness of the Company's disclosure controls and procedures. The Company's management necessarily applied its judgment in assessing the costs and benefits of such controls and procedures, which by their nature can provide only reasonable assurance regarding management's control objectives. Based on this evaluation, the Company's Chief Executive Officers and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective at the reasonable assurance level for gathering, analyzing and disclosing the information the Company is required to disclose in the reports it files under the Securities Exchange Act of 1934, within the time periods specified in the SEC's rules and forms.

There has been no change in the Company's internal control over financial reporting that occurred during the period covered by this annual report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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**Item 16A. Audit Committee Financial Expert**

**Item 16B. Code Of Ethics And Conduct**

**Item 16. [RESERVED]**

**Item 16A. AUDIT COMMITTEE FINANCIAL EXPERT**

After renewal as per the resolutions by the Shareholders Meeting of April 13, 2006, the Board of Auditors has determined that each of its members is an audit committee financial expert as defined in Item 16A of Form 20-F. For the names of the members of the Board of Auditors, see Item 6. Directors, Senior Management and Employees 6.3 Board of Auditors , Item 10. Additional Information 10.1 Corporate Governance 10.1.2 General Board of Directors Board of Auditors .

**Item 16B. CODE OF ETHICS AND CONDUCT**

On March 23, 2004, Telecom Italia adopted a new Code of Ethics and Conduct which applies to the Executive Chairman, the Chief Executive Officers, the Chief Financial Officers, as well as to all the Group s employees in and outside Italy. The Code of Ethics and Conduct is available on Telecom Italia s website at [www.telecomitalia.it](http://www.telecomitalia.it). Item 10. Additional Information 10.1 Corporate Governance 10.1.1 Differences Telecom Italia s Corporate Governance and New York Stock Exchange Corporate Governance Practices and 10.1 Corporate Governance 10.1.2 General Code of Ethics and Conduct .

**Table of Contents****Item 16C. Principal Accountant Fees And Services****Item 16C. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

Ernst & Young served as Telecom Italia's primary independent auditors since the year ended December 31, 2001.

Ernst & Young means Reconta Ernst & Young S.p.A., the auditor of the Company, as well as all the Italian and foreign entities belonging to the Ernst & Young Global Network.

The following table sets forth the aggregate fees for professional services and other services rendered by Ernst & Young in 2005 and 2004.

| <b>Type of Fees</b>   | <b>For the fiscal year ended<br/>December 31,</b> |               |
|-----------------------|---|---------------|
|                       | <b>2004</b>                                       | <b>2005</b>   |
|                       | <b>(millions of Euro)</b>                         |               |
| Audit Fees(1)         | 10,768  | 13,434        |
| Audit-related Fees(2) | 1,664   | 843           |
| Tax Fees(3)           | 79  |               |
| <b>Total</b>          | <b>12,511</b>                                     | <b>14,277</b> |

(1) Audit fees consisted of fees for professional services in connection with Telecom Italia's annual financial statements, reviews of interim financial statements as well as comfort letters issued in relation to capital market transactions, agreed upon procedures for certain financial statement areas, the agreed upon procedures required under Italian regulations for the Merger, and technical Accounting Consultations.

(2) Audit-related fees consisted of fees billed for professional services rendered in connection with assurance and related services not included under Audit Fees.

(3) Tax fees consisted of fees billed for professional services rendered in connection with tax planning, compliance and advice.

**Audit Committee's Pre-Approval Policies and Procedures**

The Board of Auditors (also in its role as Telecom Italia's Audit Committee), in accordance with and to the extent permitted by applicable Italian law, is responsible for the appointment, retention and oversight of the work of the Company's external auditors engaged for the purpose of issuing the audit report on the annual financial statements. To this effect, the Board of Auditors makes a recommendation to the Shareholders' Meeting which appoints the external auditors and determines their compensation. On May 6, 2004, the Telecom Italia Shareholders' Meeting appointed Reconta Ernst & Young S.p.A. ( **E&Y** ) as external auditors for the

three-year period 2004, 2005 and 2006.

In October 2003, Telecom Italia, together with the Board of Auditors, adopted the Group Procedure for the Appointment of Auditors (the Group Procedure). The Group Procedure requires that E&Y be appointed throughout the Group with any exceptions subject to prior approval by the Director with delegated authority and the Board of Auditors. The Group Procedure pre-approved certain audit and permissible non-audit services to be provided by the external auditors (and associated persons) and prohibited certain services. According to the Group Procedure, the Board of Auditors pre-approved (subject to annual review) the following audit and permitted non-audit services:

**Audit Services:**

1. Audit of annual and interim financial statements on the basis of applicable laws and regulations (including the audit of SEC registered companies' annual report).
2. Audit of annual and interim financial consolidated reporting packages.
3. Audit conformity of the Telecom Italia Group's sustainability reports or social reports.
4. Reports or opinions required by law for specific transactions from the auditor appointed to audit the annual financial statements, to the extent permitted.
5. Audits governed by the principles of national and international auditing such as:
  - procedures performed in relation to the issuance of a comfort letter (including for pro forma accounts and/or balance sheets) in relation to the carrying out of extraordinary financial operations;

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### **Item 16C. Principal Accountant Fees And Services**

- audits agreed with management covering specific areas or accounts or accounting situations, to support the audit of periodic statements; and
  - auditing of subsidiaries and associated companies (including review of the working papers of other auditors) made necessary for the purpose of auditing the periodic statements of the company being audited.
6. Audit of annual accounts and/or balance sheets to be published in prospectuses, information documents, offering memoranda and similar documents.
  7. Services required by regulatory authorities and control agencies (such as, for example, those connected with so-called regulatory accounting ).
  8. Audit of statements required by national or supranational administrations (e.g. the EU) for the concession of grants or loans for specific actions or projects.
  9. Audits aimed at issuance of an attestation of the system of internal control under Section 404 of the Sarbanes-Oxley Act.

### **Permitted Non-audit Services:**

1. Audits in the following areas:
  - procedures for auditing associated companies provided for by agreements between shareholders (in relation to so-called audit rights );
  - financial due diligence procedures on companies to be bought or sold;
  - procedures performed in the area of regulatory accounting;
  - procedures performed on areas related to internal control in support of the internal auditor.
2. Opinions on accounting and reporting including those regarding (i) application of new accounting principles and new regulations on accounting and regulatory reporting, (ii) implementation of accounting principles current in other countries, (iii) implementation of rules and regulations issued by the SEC, CONSOB and similar bodies.
3. Assistance to the internal audit department within the limits imposed by SEC regulations.

The pre-approved services listed above are in all cases subject to scrutiny by the Director with delegated powers for internal controls by the Board of Directors who may (by his own initiative or on request by the Committee for Internal Control and Corporate

Governance or by the Board of Auditors) request supplementary documentation to verify the independent status of the auditor and take appropriate action if necessary.

Services that are not included in one of the categories listed above require specific pre-approval of the Director with delegated powers for internal controls by the Board of Directors (currently the chairman of the Board of Directors) and the Board of Auditors. An approval may not be granted if the service falls within a category of services not permitted by current law or if it is inconsistent with maintaining auditor independence.

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**Item 16D. Exemptions from the listing standards for Audit**

**Committees**

**Item 16E. Repurchases of equity securities**

**Item 16D. EXEMPTIONS FROM THE LISTING STANDARDS FOR AUDIT COMMITTEES**

Please see Item 10. Additional Information 10.1 Corporate Governance 10.1.2 General Board of Directors Board of Auditors Audit Committee .

**Item 16E. REPURCHASES OF EQUITY SECURITIES**

From January 1, 2005, to December 31, 2005, no purchases were made by or on behalf of Telecom Italia or any affiliated purchaser of Shares or Savings Shares.

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**Item 17. Financial Statements**

**PART III**

**Item 17. FINANCIAL STATEMENTS**

Not applicable.

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**Item 18. Financial Statements**

**Item 19. Financial Statements and Exhibits**

**Item 18. FINANCIAL STATEMENTS**

Reference is made to Item 19 for a list of all financial statements filed as part of this Annual Report.

**Item 19. FINANCIAL STATEMENTS AND EXHIBITS**

***(a) Financial Statements***

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***(b) Exhibits***

1.1 Bylaws of the Company.

2.1 Deposit Agreements.

(a) Deposit Agreement dated as of July 17, 2003, as amended, among the Company, JPMorgan Chase Bank, as Depositary and the holders from time to time of American Depositary Receipts representing Ordinary Shares of the Company.(1)

(b) Deposit Agreement dated as of July 17, 2003, as amended, among the Company, JPMorgan Chase Bank, as Depositary and holders from time to time of American depositary Receipts representing Savings shares of the Company.(2)

2.2 (a) Trust deed dated January 23, 2004, between Telecom Italia (as Issuer and Guarantor), Telecom Italia Finance (as Issuer) and J.P. Morgan Corporate Trustee Services Limited relating to a 10 billion Euro Medium Term Note Program. We hereby agree to

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furnish to the Commission, upon its request, a copy of any instrument defining the rights of holders of our long-term debt or that of our subsidiaries for which consolidated or unconsolidated financial statements are required to be filed.(3)

(b) First Supplemental Trust Deed, dated February 17, 2006, modifying the Trust Deed dated January 23, 2004 relating to the 10 billion Euro Medium Term Note Program.

(c) Second Supplemental Trust Deed, dated December 2, 2005, modifying and restating the Trust Deed dated January 23, 2004 (as previously modified) relating to the 10 billion Euro Medium Term Note Program.

### 4.1 Public Telecommunications License.(4)

(a) Decision No. 820/00/CONS of 22.11.2000. Individual license for installation and supply of public telecommunications network and for the provision to the public of a voice telephony service (*modifications to the concessions and annexed conventions, ex SIP, Iritel and Italcable*).

### 4.2 Stock Option Plans.

(a) 2002 Top Plan regulations and form of Letter of Assignment addressed to participants of the plan.(5)

(b) 2002 Plan regulations and form of Letter of Assignment addressed to participants of the plan.(5)

(c) 2002-2004 Stock Option Plan (Olivetti).(6)

(d) February 2002-December 2004 Stock Option Plan (Olivetti).(6)

(e) TIM Stock Option Plan 2000-2002 plan rules and form of Letter of Assignment addressed to participants of the plan.

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**Item 19. Financial Statements and Exhibits**

(f) TIM Stock Option Plan 2002-2003 plan rules and form of Letter of Assignment addressed to participants of the plan.

(g) TIM Stock Option Plan 2003-2005 plan rules and form of Letter of Assignment addressed to participants of the plan.

8.1 List of Subsidiaries.(7)

12(a) Certification by the Executive Chairman of Telecom Italia S.p.A..

12(b) Certification by the Chief Executive Officer of Telecom Italia S.p.A..

12(c) Certification by the Chief Executive Officer of Operations of Telecom Italia S.p.A..

12(d) Certification by the Head of Finance, Administration and Control of Telecom Italia S.p.A..

13.1 Section 906 Certification submitted for the purpose of complying with Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and Section 1350 of Chapter 63 of Title 18 of the United States Code.

15(a) Consent of Independent Registered Public Accounting Firm.

(1) Incorporated by reference to exhibit (a) filed with Olivetti s Registration Statement on Form F-6 filed with the SEC on July 18, 2003 (File No. 333-107144).

(2) Incorporated by reference to exhibit (a) filed with Olivetti s Registration Statement on Form F-6 filed with the SEC on July 18, 2003 (File No. 333-107142).

(3) Incorporated by reference to the Exhibits filed with the Company s Annual Report on Form 20-F on June 10, 2004 (File No. 001-13882).

(4) Incorporated by reference to the Exhibits filed with the Company s Annual Report on Form 20-F/A on June 29, 2001 (File No. 001-13882).

(5) Incorporated by reference to the Exhibits filed with the Company s Annual Report for the fiscal year ended December 31, 2002 on Form 20-F filed with the SEC on June 26, 2003 (File No. 001-13882).

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- (6) Incorporated by reference to the Exhibits filed with the Company's Annual Report on Form 20-F on June 10, 2004 (File No. 001-13882).
- (7) Please see Note 41-List of Companies of the Telecom Italia Group of the Notes to the Consolidated Financial Statements included elsewhere herein.

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Item 19. Financial Statements and Exhibits

**SIGNATURE**

Pursuant to the requirements of Section 12 of the Securities Exchange Act of 1934, the registrant certifies that it meets all the requirements for filing on Form 20-F and has duly caused this Annual Report to be signed on its behalf by the undersigned, thereunto duly authorized.

**TELECOM ITALIA S.p.A**

By:                     /s/ CARLO ORAZIO BUORA                    

**Name: Carlo Orazio Buora**  
**Title: Chief Executive Officer**

Dated May 19, 2006

**Table of Contents****TELECOM ITALIA S.P.A.****CONSOLIDATED FINANCIAL STATEMENTS****AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2005 AND 2004**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Shareholders of

Telecom Italia S.p.A.

We have audited the accompanying consolidated balance sheets of Telecom Italia S.p.A. and subsidiaries (the Company) as of December 31, 2005 and 2004, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the two years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Company's internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Telecom Italia S.p.A. and subsidiaries at December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the two years in the period ended December 31, 2005, in conformity with International Financial Reporting Standards as adopted by the European Union.

International Financial Reporting Standards as adopted by the European Union vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in Notes 43, 44 and 45 to the consolidated financial statements.

/s/ Reconta Ernst & Young S.p.A.

Milan, Italy

March 22, 2006



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except for notes 43, 44 and 45 as to which the date is

May 12, 2006

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Financial Statements

Consolidated Balance Sheets

**CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2004 AND 2005****ASSETS**

|   | Note | As of December 31, |               |
|---|------|--------------------|---------------|
|   |      | 2004               | 2005          |
|   |      | (millions of Euro) |               |
| <b>NON-CURRENT ASSETS</b>   |      |                    |               |
| <b>Intangible assets</b>  |      |                    |               |
| Goodwill and other intangible assets with an indefinite life                  | 6    | 27,459             | 43,980        |
| Intangible assets with a finite life  | 7    | 6,774              | 6,810         |
|   |      | <u>34,233</u>      | <u>50,790</u> |
| <b>Tangible assets</b>  |      |                    |               |
| Property, plant and equipment owned   | 8    | 17,853             | 16,443        |
| Assets held under finance leases  |      | 1,653              | 1,598         |
|   |      | <u>19,506</u>      | <u>18,041</u> |
| <b>Other non-current assets</b>   |      |                    |               |
| Equity investments  | 9    | 1,064              | 1,342         |
| Securities and financial receivables  |      | 393                | 996           |
| Miscellaneous receivables and other non-current assets                        |      | 881                | 825           |
|   |      | <u>2,338</u>       | <u>3,163</u>  |
| <b>Deferred tax assets</b>  | 10   | <u>4,114</u>       | <u>2,793</u>  |
| <b>TOTAL NON-CURRENT ASSETS (A)</b>   |      | <u>60,191</u>      | <u>74,787</u> |
| <b>CURRENT ASSETS</b>   |      |                    |               |
| <b>Current assets, excluding discontinued operations/assets held for sale</b> |      |                    |               |
| Inventories   | 11   | 334                | 294           |
| Trade and miscellaneous receivables and other current assets                  | 12   | 10,155             | 9,191         |
| Securities other than equity investments                                      | 13   | 457                | 378           |
| Financial receivables and other current financial assets                      | 14   | 662                | 509           |
| Cash and cash equivalents   | 15   | 8,855              | 10,323        |
|   |      | <u>20,463</u>      | <u>20,695</u> |
| <b>Discontinued operations/Assets held for sale</b>                           |      |                    |               |
| of a financial nature   | 16   | 84                 | 37            |
| of a non-financial nature   |      | 1,096              | 491           |
|   |      | <u>1,180</u>       | <u>528</u>    |

|                                 |               |               |
|---------------------------------|---------------|---------------|
| <b>TOTAL CURRENT ASSETS (B)</b> | <b>21,643</b> | <b>21,223</b> |
| <b>TOTAL ASSETS (A+B)</b>       | <b>81,834</b> | <b>96,010</b> |

The accompanying notes are an integral part of these financial statements

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Financial Statements

Consolidated Balance Sheets

**CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2004 AND 2005****SHAREHOLDERS EQUITY AND LIABILITIES**

|  | Note | As of December 31, |               |
|--|------|--------------------|---------------|
|  |      | 2004               | 2005          |
|  |      | (millions of Euro) |               |
| <b>SHAREHOLDERS EQUITY</b>   | 17   |                    |               |
| Share capital issued   |      | 8,865              | 10,668        |
| Less: Treasury shares  |      | (56)               | (69)          |
| <b>Share Capital</b>   |      | <b>8,809</b>       | <b>10,599</b> |
| Reserves   |      | 4,184              | 10,984        |
| Retained earnings (accumulated losses), including net income (loss) for the year                           |      | 3,255              | 4,079         |
| <b>Shareholders Equity attributable to the Group</b>   |      | <b>16,248</b>      | <b>25,662</b> |
| <b>Shareholders Equity attributable to Minority interests</b>  |      | <b>4,550</b>       | <b>1,323</b>  |
| <b>TOTAL SHAREHOLDERS EQUITY (A)</b>   |      | <b>20,798</b>      | <b>26,985</b> |
| <b>NON-CURRENT LIABILITIES</b>   |      |                    |               |
| Non-current financial liabilities  | 18   | 38,725             | 42,146        |
| Employee severance indemnities and other employee-related reserves   | 19   | 1,222              | 1,351         |
| Reserve for deferred taxes   | 10   | 170                | 137           |
| Reserves for risks and future charges  | 20   | 815                | 797           |
| Miscellaneous payables and other non-current liabilities   | 21   | 2,199              | 2,113         |
| <b>TOTAL NON-CURRENT LIABILITIES (B)</b>   |      | <b>43,131</b>      | <b>46,544</b> |
| <b>CURRENT LIABILITIES</b>   |      |                    |               |
| <b>Current liabilities, excluding liabilities relating to discontinued operations/assets held for sale</b> |      |                    |               |
| Current financial liabilities  | 18   | 4,400              | 9,812         |
| Trade payables, tax payables, miscellaneous payables and other current liabilities                         | 22   | 12,733             | 12,384        |
|  |      | <b>17,133</b>      | <b>22,196</b> |
| <b>Liabilities relating to discontinued operations/assets held for sale</b>                                | 16   |                    |               |
| of a financial nature  |      | 188                | 143           |
| of a non-financial nature  |      | 584                | 142           |
|  |      | <b>772</b>         | <b>285</b>    |
| <b>TOTAL CURRENT LIABILITIES (C)</b>   |      | <b>17,905</b>      | <b>22,481</b> |

|  |               |               |
|--|---------------|---------------|
| <b>TOTAL LIABILITIES (D=B+C)</b>                       | <b>61,036</b> | <b>69,025</b> |
| <b>TOTAL SHAREHOLDERS EQUITY AND LIABILITIES (A+D)</b> | <b>81,834</b> | <b>96,010</b> |

The accompanying notes are an integral part of these financial statements

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Financial Statements

Consolidated Statements Of Operations

**CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE YEARS ENDED****DECEMBER 31, 2004 AND 2005**

|   | Note | Year ended<br>December 31, |                 |
|---|------|----------------------------|-----------------|
|   |      | 2004                       | 2005            |
| (millions of Euro)  |      |                            |                 |
| Revenues  | 26   | 28,292                     | 29,919          |
| Other income  | 27   | 1,099                      | 678             |
| <b>Total operating revenues and other income</b>                              |      | <b>29,391</b>              | <b>30,597</b>   |
| Purchases of materials and external services                                  | 28   | (11,812)                   | (12,937)        |
| Personnel costs   | 29   | (3,852)                    | (4,142)         |
| Other operating expenses  | 30   | (1,603)                    | (1,468)         |
| Changes in inventories  |      | 27                         | (4)             |
| Capitalized internal construction costs                                       | 31   | 713                        | 471             |
| Depreciation and amortization   | 32   | (4,808)                    | (5,232)         |
| Gains/losses on disposals of non-current assets                               | 33   | (9)                        | 242             |
| Impairment losses/reversals on non-current assets                             | 34   | (444)                      | (28)            |
| <b>Total operating expenses</b>   |      | <b>(21,788)</b>            | <b>(23,098)</b> |
| <b>Operating income</b>   |      | <b>7,603</b>               | <b>7,499</b>    |
| Share of earnings of equity investments accounted for using the equity method | 9    | (5)                        | 23              |
| Financial income  | 35   | 2,205                      | 3,144           |
| Financial expenses  | 36   | (4,197)                    | (5,131)         |
| <b>Income from continuing operations before taxes</b>                         |      | <b>5,606</b>               | <b>5,535</b>    |
| Income taxes  | 37   | (2,654)                    | (2,395)         |
| <b>Net income from continuing operations</b>                                  |      | <b>2,952</b>               | <b>3,140</b>    |
| Net income (loss) from discontinued operations/assets held for sale           | 16   | (118)                      | 550             |
| <b>Net income</b>   |      | <b>2,834</b>               | <b>3,690</b>    |
| <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             |
| <b>Basic and Diluted Earnings Per Share (EPS)(*)</b>                          |      | <b>(Euro)</b>              | <b>(Euro)</b>   |
| Ordinary Share  |      | 0.11                       | 0.17            |
| Savings Share   |      | 0.12                       | 0.18            |
| <i>Of which:</i>  |      |                            |                 |
| <i>From continuing operations</i>   |      |                            |                 |

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|  |               |              |
|--|---------------|--------------|
| <i>Ordinary Share</i>                                    | <i>0.12</i>   | <i>0.14</i>  |
| <i>Savings Share</i>                                     | <i>0.13</i>   | <i>0.15</i>  |
| <i>From discontinued operations/assets held for sale</i> |               |              |
| <i>Ordinary Share</i>                                    | <i>(0.01)</i> | <i>0.03</i>  |
| <i>Savings Share</i>                                     | <i>(0.01)</i> | <i>0.03</i>  |
|  | <b>_____</b>  | <b>_____</b> |

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(\*) Basic EPS is equal to Diluted EPS.

The accompanying notes are an integral part of these financial statements

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Financial Statements

Consolidated Statement Of Changes In Shareholders Equity

**CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY FOR THE YEAR ENDED****DECEMBER 31, 2004**

Attributable to the Group

|  | Share capital | Additional paid-in capital | Reserve for net translation differences | Other income (charges) recognized directly in equity | Other reserves | Retained earnings (accumulated losses) including net income (loss) for the year | Total  | Minority interests | Total shareholders equity |
|--|---------------|----------------------------|---|--|----------------|---|--------|--------------------|---------------------------|
| (millions of Euro)   |               |                            |   |  |                |   |        |                    |                           |
| <b>Balance at December 31, 2003 in accordance with Italian GAAP</b>                  | 8,854         | 88                         |   |  | 4,768          | 2,382   | 16,092 | 4,497              | 20,589                    |
| Adoption of IFRS   | (56)          | (56)                       |   | (18)   | (521)          | 814   | 163    | 32                 | 195                       |
| <b>Balance at December 31, 2003 in accordance with IFRS</b>                          | 8,798         | 32                         |   | (18)   | 4,247          | 3,196   | 16,255 | 4,529              | 20,784                    |
| <b>Changes in shareholders equity during 2004:</b>                                   |               |                            |   |  |                |   |        |                    |                           |
| Fair value adjustments of available-for-sale financial assets:                       |               |                            |   |  |                |   |        |                    |                           |
| • Fair value adjustments   |               |                            |   | 52   |                |   | 52     |                    | 52                        |
| • Gains/losses transferred to statement of operations                                |               |                            |   | (9)  |                |   | (9)    |                    | (9)                       |
| Fair value adjustments of hedging instruments:                                       |               |                            |   |  |                |   |        |                    |                           |
| • Fair value adjustments of financial instruments designated as cash flow hedges     |               |                            |   | (313)  |                |   | (313)  |                    | (313)                     |
| • Gains/losses transferred to statement of operations                                |               |                            |   | 100  |                |   | 100    |                    | 100                       |
| Translation differences  |               |                            | (50)                                    |  |                |   | (50)   | (26)               | (76)                      |
| Income taxes   |               |                            |   | 81   |                |   | 81     |                    | 81                        |
| <b>Income/(loss) recognized directly in equity other comprehensive income/(loss)</b> |               |                            | (50)                                    | (89)   |                |   | (139)  | (26)               | (165)                     |
| <b>Net income</b>  |               |                            |   |  |                | 1,815   | 1,815  | 1,019              | 2,834                     |
| <b>Total comprehensive income (loss)</b>   |               |                            | (50)                                    | (89)   |                | 1,815   | 1,676  | 993                | 2,669                     |



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|   |              |           |             |              |              |              |               |              |               |
|---|--------------|-----------|-------------|--------------|--------------|--------------|---------------|--------------|---------------|
| • Dividends approved                                  |              |           |             |              | (1,730)      | (1,730)      | (1,050)       | (2,780)      |               |
| • Conversion of bonds                                 | 1            | 3         |             |              |              | 4            |               | 4            |               |
| • Exercise of stock options                           | 10           | 30        |             |              |              | 40           | 207           | 247          |               |
| • Dilution of TIM shares held following stock options |              |           |             | 66           |              | 66           | (66)          |              |               |
| • Effect of consolidation of TIM shares               |              |           |             |              |              |              | (20)          | (20)         |               |
| • Other changes                                       |              |           |             | (37)         | (26)         | (63)         | (43)          | (106)        |               |
| <b>Balance at December 31, 2004</b>                   | <b>8,809</b> | <b>65</b> | <b>(50)</b> | <b>(107)</b> | <b>4,276</b> | <b>3,255</b> | <b>16,248</b> | <b>4,550</b> | <b>20,798</b> |

The accompanying notes are an integral part of these financial statements

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Financial Statements

Consolidated Statement Of Changes In Shareholders Equity

**CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS EQUITY FOR THE YEAR ENDED****DECEMBER 31, 2005**

Attributable to the Group

|  | Share capital | Additional paid-in capital | Reserve for net translation differences | Other income (charges) recognized directly in equity | Other reserves | Retained earnings (accumulated losses) including net income (loss) for the year | Total         | Minority interests | Total shareholders equity |
|--|---------------|----------------------------|---|--|----------------|---|---------------|--------------------|---------------------------|
| (millions of Euro)   |               |                            |   |  |                |   |               |                    |                           |
| <b>Balance at December 31, 2004 in accordance with Italian GAAP</b>                  | 8,865         | 120                        |   |  | 4,809          | 1,378   | 15,172        | 4,689              | 19,861                    |
| Adoption of IFRS   | (56)          | (55)                       | (50)                                    | (107)  | (533)          | 1,877   | 1,076         | (139)              | 937                       |
| <b>Balance at December 31, 2004 in accordance with IFRS</b>                          | <b>8,809</b>  | <b>65</b>                  | <b>(50)</b>                             | <b>(107)</b>   | <b>4,276</b>   | <b>3,255</b>  | <b>16,248</b> | <b>4,550</b>       | <b>20,798</b>             |
| <b>Changes in shareholders equity during 2005:</b>                                   |               |                            |   |  |                |   |               |                    |                           |
| Fair value adjustments of available-for-sale financial assets:                       |               |                            |   |  |                |   |               |                    |                           |
| • Fair value adjustments   |               |                            |   | 57   |                |   | 57            |                    | 57                        |
| • Gains/losses transferred to statement of operations                                |               |                            |   | (11)   |                |   | (11)          |                    | (11)                      |
| Fair value adjustments of hedging instruments:                                       |               |                            |   |  |                |   |               |                    |                           |
| • Fair value adjustments of financial instruments designated as cash flow hedges     |               |                            |   | (122)  |                |   | (122)         |                    | (122)                     |
| • Gains/losses transferred to statement of operations                                |               |                            |   | 75   |                |   | 75            |                    | 75                        |
| Translation differences  |               |                            | 848                                     |  |                |   | 848           | 357                | 1,205                     |
| Income taxes   |               |                            |   | (1)  |                |   | (1)           |                    | (1)                       |
| <b>Income (loss) recognized directly in equity other comprehensive income/(loss)</b> |               |                            | <b>848</b>                              | <b>(2)</b>   |                |   | <b>846</b>    | <b>357</b>         | <b>1,203</b>              |
| <b>Net income</b>  |               |                            |   |  |                | <b>3,216</b>  | <b>3,216</b>  | <b>474</b>         | <b>3,690</b>              |
| <b>Total comprehensive income (loss)</b>   |               |                            | <b>848</b>                              | <b>(2)</b>   |                | <b>3,216</b>  | <b>4,062</b>  | <b>831</b>         | <b>4,893</b>              |

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|   |               |              |            |              |              |              |               |              |               |
|---|---------------|--------------|------------|--------------|--------------|--------------|---------------|--------------|---------------|
| • Dividends approved  |               |              |            |              | (1,912)      | (1,912)      | (430)         | (2,342)      |               |
| • Conversion of bonds   | 488           | 1,640        |            | (315)        |              | 1,813        |               | 1,813        |               |
| • Exercise of stock options                                     | 6             | 23           |            |              |              | 29           |               | 29           |               |
| • Tender offer and additional acquisition of shares             |               |              |            |              |              |              | (2,124)       | (2,124)      |               |
| • Merger of TIM into Telecom Italia                             | 1,309         | 4,768        |            | (64)         |              | 6,013        | (1,102)       | 4,911        |               |
| • Transfer of Internet business from TI Media to Telecom Italia |               |              |            |              | (364)        | (364)        | 364           |              |               |
| • Tender offer on TI Media shares                               |               |              |            |              |              |              | (134)         | (134)        |               |
| • Reorganization of Mobile business segment in Brazil           |               |              |            |              | (14)         | (14)         | 40            | 26           |               |
| • Entel Bolivia capital reimbursement                           |               |              |            |              |              |              | (160)         | (160)        |               |
| • Changes in the scope of consolidation                         |               |              |            | (5)          |              | (5)          | (577)         | (582)        |               |
| • Telecom Italia shares held by TI Finance                      | (13)          |              |            |              |              | (13)         |               | (13)         |               |
| • Other movements   |               | (31)         |            | (62)         | (102)        | (195)        | 65            | (130)        |               |
| <b>Balance at December 31, 2005 in accordance with IFRS</b>     | <b>10,599</b> | <b>6,465</b> | <b>793</b> | <b>(109)</b> | <b>3,835</b> | <b>4,079</b> | <b>25,662</b> | <b>1,323</b> | <b>26,985</b> |

The accompanying notes are an integral part of these financial statements

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Financial Statements

Consolidated Statements Of Cash Flows

**CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED****DECEMBER 31, 2004 AND 2005**

|   | Note  | Year ended December 31, |                 |
|---|-------|-------------------------|-----------------|
|   |       | 2004                    | 2005            |
|   |       | (millions of Euro)      |                 |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |       |                         |                 |
| Net income from continuing operations   |       | 2,952                   | 3,140           |
| <i>Adjustments to reconcile net income from continuing operations to cash flows generated (used) by operating activities:</i> |       |                         |                 |
| Depreciation and amortization   |       | 4,808                   | 5,232           |
| Impairment losses on non-current assets (including equity investments)  |       | 446                     | 3               |
| Net change in deferred tax assets and liabilities   |       | 1,124                   | 1,347           |
| Net realized (gains)/losses on disposal of non-current assets (including equity investments)                                  |       | (106)                   | (327)           |
| Share of earnings of equity investments accounted for using the equity method   |       | 5                       | (23)            |
| Change in employee severance indemnities and other employee-related reserves  |       | (39)                    | 255             |
| Change in other operating assets/liabilities:   |       |                         |                 |
| • Change in inventories   |       | (24)                    | (5)             |
| • Change in trade receivables   |       | 51                      | 329             |
| • Change in trade payables  |       | 1,079                   | 342             |
| • Net change in other assets/liabilities  |       | (30)                    | (357)           |
|   |       | <u>10,266</u>           | <u>9,936</u>    |
| <b>CASH FLOWS GENERATED BY OPERATING ACTIVITIES (A)</b>   |       |                         |                 |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |       |                         |                 |
| Acquisition of intangible assets  | 7     | (1,882)                 | (1,785)         |
| Acquisition of tangible assets  | 8     | (3,120)                 | (3,388)         |
| Acquisition of equity investments in subsidiaries and businesses, net of cash acquired (I)                                    | 4,6,7 | (1)                     | (390)           |
| Acquisition of other equity investments   | 4,6,9 | (867)                   | (14,544)        |
| Change in financial receivables and other financial assets  |       | 424                     | (474)           |
| Consideration received on the sale of equity investments in subsidiaries, net of cash disposed of (II)                        | 6,16  | 43                      | 2,052           |
| Consideration received on the sale of tangible, intangible and other non-current assets and capital reimbursements            |       | 452                     | 950             |
|   |       | <u>(4,951)</u>          | <u>(17,579)</u> |
| <b>CASH FLOWS USED IN INVESTING ACTIVITIES (B)</b>  |       |                         |                 |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |       |                         |                 |
| Net change in current financial liabilities   |       | 1,247                   | (1,053)         |
| Proceeds from debt issuance and non-current financial liabilities (including current portion)                                 |       | 7,845                   | 15,357          |
| Repayment of debt and non-current financial liabilities (including current portion)   |       | (8,270)                 | (3,151)         |
| Consideration received for equity instruments   |       | 193                     | 102             |
| Share capital increases/repayments, net of the related costs  |       | 51                      | (160)           |
| Dividends paid to minority shareholders (distribution of reserves included)   |       | (2,780)                 | (2,328)         |
|   |       | <u>(1,714)</u>          | <u>8,767</u>    |
| <b>CASH FLOWS GENERATED BY (USED IN) FINANCING ACTIVITIES (C)</b>   |       |                         |                 |

|   |    |                   |                   |
|---|----|-------------------|-------------------|
| <b>CASH FLOWS GENERATED BY (USED IN) DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE (D)</b> | 16 | (109)             | 26                |
|   |    | <u>          </u> | <u>          </u> |
| <b>AGGREGATE CASH FLOWS (E=A+B+C+D)</b>   |    | <b>3,492</b>      | <b>1,150</b>      |
|   |    | <u>          </u> | <u>          </u> |
| <b>NET CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR (F)</b>                     |    | <b>5,211</b>      | <b>8,667</b>      |
| Net effect of foreign currency translation on net cash and cash equivalents (G)           |    | (36)              | 141               |
|   |    | <u>          </u> | <u>          </u> |
| <b>NET CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR (H=E+F+G)</b>                     |    | <b>8,667</b>      | <b>9,958</b>      |
|   |    | <u>          </u> | <u>          </u> |

(I) Net of changes in payables following the acquisition.

(II) Net of changes in receivables as a result of the disposal.

The accompanying notes are an integral part of these financial statements

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Financial Statements

Consolidated Statements Of Cash Flows

**CONSOLIDATED STATEMENTS OF CASH FLOWS FOR  
THE YEARS ENDED DECEMBER 31, 2004 AND 2005**

|   | Year ended December 31, |               |
|---|-------------------------|---------------|
|   | 2004                    | 2005          |
|   | (millions of Euro)      |               |
| <b>ADDITIONAL CASH FLOW INFORMATION</b>   |                         |               |
| Income taxes paid   | 1,476                   | 708           |
| Interest expense paid   | 2,779                   | 2,796         |
| Interest income received  | 1,025                   | 1,067         |
| Dividends received  | 35                      | 61            |
| <b>DETAILS OF NET CASH AND CASH EQUIVALENTS</b>   |                         |               |
| <b>At the beginning of the year:</b>  |                         |               |
| • Cash and cash equivalents from continuing operations  | 5,721                   | 8,855         |
| • Adjustments to cash and cash equivalents to consider discontinued operations/assets held for sale | (206)                   | (109)         |
|   | 5,515                   | 8,746         |
| • Cash and cash equivalents classified as discontinued operations/assets held for sale              | 206                     | 210           |
|   | <b>(A) 5,721</b>        | <b>8,956</b>  |
| • Bank overdrafts repayable on demand from continuing operations                                    | (510)                   | (248)         |
| • Bank overdrafts repayable on demand from discontinued operations/assets held for sale             |                         | (41)          |
|   | <b>(B) (510)</b>        | <b>(289)</b>  |
|   | <b>(A+B) 5,211</b>      | <b>8,667</b>  |
| <b>At the end of the year:</b>  |                         |               |
| • Cash and cash equivalents from continuing operations  | 8,855                   | 10,323        |
| • Adjustments to cash and cash equivalents to consider discontinued operations/assets held for sale | (109)                   |               |
|   | 8,746                   | 10,323        |
| • Cash and cash equivalents classified as Discontinued operations/Assets held for sale              | 210                     | 37            |
|   | <b>(C) 8,956</b>        | <b>10,360</b> |
| • Bank overdrafts repayable on demand from continuing operations                                    | (248)                   | (383)         |

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|   |                   |                   |
|---|-------------------|-------------------|
| • Bank overdrafts repayable on demand from discontinued operations/assets held for sale | (41)              | (19)              |
|   | <u>          </u> | <u>          </u> |
|   | <b>(D)</b>        | <b>(289)</b>      |
|   | <u>          </u> | <u>          </u> |
|   | <b>(C+D)</b>      | <b>8,667</b>      |
|   | <u>          </u> | <u>          </u> |
|   |                   | <b>9,958</b>      |
|   |                   | <u>          </u> |

The accompanying notes are an integral part of these financial statements

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**NOTE 1 FORM AND CONTENT AND OTHER GENERAL INFORMATION**

**FORM AND CONTENT**

Telecom Italia S.p.A. is a corporation organized under the laws of the Republic of Italy. Telecom Italia S.p.A. and its subsidiaries (the **Group** ) operate mainly in Europe, the Mediterranean Basin and South America.

The Group is engaged principally in the communications sector and, particularly, in domestic and international telephone and data services on fixed lines, for final customers (retail) and other providers (wholesale), in the development of fiber optic networks, in innovative broadband services, in Internet services, in domestic and international mobile telecommunications, in the television sector using both analog and digital technology, in the office products sector and in Information Communication Technology.

The head office of the Group is located in Milan, Italy.

The consolidated financial statements of the Telecom Italia Group are expressed in millions of euro which is also the currency of the primary economies in which the Group operates. The foreign subsidiaries are included in the consolidated financial statements in accordance with the accounting policies described in Note 3 Accounting policies Consolidation .

The consolidated financial statements as of and for the year ended December 31, 2005 have been prepared in accordance with International Financial Reporting Standards issued by the International Accounting Standards Board (IASB) and endorsed by the European Union (IFRS). IFRS also include all effective International Accounting Standards (IAS) and all related interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC), comprising those previously issued by the Standing Interpretations Committee (SIC). For comparative purposes, the consolidated financial statements as of and for the year ended December 31, 2004 have also been prepared in accordance with IFRS, as required by IFRS 1 (First-time Adoption of International Financial Reporting Standards).

As a result of certain clarifications and interpretations issued by the Italian Accounting Board ( OIC ), during 2005, certain adjustments and reclassifications have been made to the information included in the First Quarter 2005 Report in the discussion of Transition to IAS/IFRS standards . Such changes, which had no effect on net income for the year ended December 31, 2004, reduced Shareholders' equity by an insignificant amount, as a result of recording the amount receivable from shareholders for capital contributions as a deduction from equity.

The Group did not opt for the early adoption of any IFRS in 2005.



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The consolidated financial statements at December 31, 2005 and 2004 have been prepared as follows:

- in the comparative balance sheet at December 31, 2004, discontinued operations includes only the companies considered to be discontinued operations at that date (the Finsiel group and Corporacion Digitel) as required by IFRS 5;
- the balance sheet adjusted as of December 31, 2004, reported for comparative purposes in the Item 5. Operating and Financial Review and Prospects, takes into account, of all discontinued operations/assets held for sale (Finsiel Group, Corporacion Digitel, Entel Chile Group, TIM Hellas, TIM Perù and Gruppo Buffetti) and the related liabilities;
- the statements of operations and cash flows for the year 2004 have been prepared on a basis consistent with that of 2005. The results of discontinued operations/assets held for sale have been reclassified to Net income (loss) from discontinued operations/assets held for sale in the statement of operations and Cash flows generated by (used in) discontinued operations/assets held for sale in the statement of cash flows.

As a result, the amounts described in the explanatory notes to the balance sheet for comparative purposes do not agree with the information in the statements of operations and cash flows (for example, depreciation and amortization, impairments, disposals, etc.).

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**SEASONAL FACTORS AFFECTING REVENUES**

- **Wireline**

In 2005 and 2004, revenues from basic subscription charges and traffic related to fixed telecommunications were not significantly affected by seasonal factors. However, the promotional campaigns launched during 2005 had a positive impact on product sales.

- **Mobile**

Revenues from voice traffic related to the domestic mobile business were not affected by seasonal factors. Marketing campaigns affected revenues from sale of products and also revenues from Value Added Services (VAS) only marginally. Nevertheless, certain seasonal factors exist relating to the number of holidays during the year.

**SCOPE OF CONSOLIDATION**

Excluding the effects of discontinued operations/assets held for sale (discussed below), the impact of other changes in the scope of consolidation on the balance sheet, the result of operations and cash flows is not material.

These changes can be summarized as follows.

Compared to December 31, 2004:

a) additions to the scope of consolidation:

*Wireline:* Rits Tele.com. B.V. (purchased in March 2005), Nuova Tin.it S.r.l. (established in May 2005), Liberty Surf Group S.A. (purchased on May 31, 2005), Telecom Italia Data Center S.r.l. (established in August 2005) and Telecom Italia Sparkle France S.a.S. (established in August 2005);

*Other Activities:* Progetto Italia S.p.A. (established in January 2005) and Ascai Servizi S.r.l. (purchased in May 2005);

b) eliminations from the scope of consolidation:

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*Wireline:* Med 1/c-1 (1999) Ltd (sold in July 2005) and Kmatrix (deleted from the Companies Register in July 2005);

*Media:* Televoice S.p.A. (sold in January 2005), Databank S.p.A. and Dbk S.A. (sold in March 2005);

*Olivetti:* Innovis S.p.A. (controlling interest sold in January 2005), Cell-Tell S.p.A. (controlling interest sold in March 2005), Olivetti Servicios y Soluciones Integrales S.A. de C.V. in liquidation (deleted from the Companies Register in March 2005), Olivetti Lexikon Nordic AB in liquidation (closed in April 2005), Olivetti Tecnost Africa Ltd (sold in July 2005) and Olivetti Peruana S.A. (deleted from the Companies Register in November 2005);

### c) merged companies:

*Wireline:* Finanziaria Web S.p.A., Ism S.r.l. and Telecom Italia Data Center S.r.l. merged into Telecom Italia S.p.A.; Tiscali Telecom S.a.S., Tiscali Contact S.A., Tiscali Media S.A., Film non Stop S.A. and Telecom Italia France S.a.S. merged into Tiscali Access S.A., then renamed Telecom Italia S.A.; Rits Tele.com B.V. merged in BBNed;

*Mobile:* Telecom Italia Mobile S.p.A. merged into Telecom Italia S.p.A.;

*Olivetti:* Olivetti Sistema e Servicos Ltda merged into Olivetti do Brasil and Olivetti Tecnost de Mexico S.A. de C.V. merged into Olivetti Mexicana S.A..

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At December 31, 2005 and 2004, Telecom Italia's subsidiaries, associates and jointly controlled companies are detailed as follows:

|  | At December 31, 2005 |            |            |
|--|----------------------|------------|------------|
|  | Italy                | Abroad     | Total      |
| <b>Companies:</b>  |                      |            |            |
| consolidated subsidiaries on a line-by-line basis                  | 51                   | 99         | (*)150     |
| jointly controlled companies accounted for using the equity method | 1                    | 9          | 10         |
| associates accounted for using the equity method                   | 31                   | 12         | 43         |
| <b>Total companies</b>   | <b>83</b>            | <b>120</b> | <b>203</b> |
|  |                      |            |            |
|  | At December 31, 2004 |            |            |
|  | Italy                | Abroad     | Total      |
| <b>Companies:</b>  |                      |            |            |
| consolidated subsidiaries on a line-by-line basis                  | 79                   | 127        | (*)206     |
| jointly controlled companies accounted for using the equity method |                      | 9          | 9          |
| associates accounted for using the equity method                   | 52                   | 23         | 75         |
| <b>Total companies</b>   | <b>131</b>           | <b>159</b> | <b>290</b> |

(\*) Including subsidiaries held for sale.

For further details see Note 41 List of companies of the Telecom Italia Group .

**DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE**

In the statement of operations for the years 2005 and 2004, the following have been classified as Discontinued operations/assets held for sale : the Entel Chile group (sold in March 2005), the Finsiel group and TIM Hellas (sold in June 2005), TIM Perù (sold in August 2005), the Gruppo Buffetti (sold in January 2006) and Corporacion Digitel (held for sale).

In the balance sheet as of December 31, 2005, the Gruppo Buffetti and Corporacion Digitel have been classified as Discontinued operations/assets held for sale and in the comparative balance sheet as of December 31, 2004 the Finsiel group and Corporacion

Digitel have been classified as Discontinued operations/assets held for sale .

## NOTE 2 REGULATION

The legal framework for regulation of the telecommunications sector in Italy was substantially revised in 2003 as a result of the adoption of the EU Directives of the review package (the Framework directive and other directives on Access , Authorization and Universal Service , collectively referred to as the Code ). Law No. 166 of August 1, 2002 gave the Government a mandate to implement the new directives and to adopt legal and regulatory measures in the field of telecommunications. The European Commission has also published recommendations related to significant product and services markets in the sector of electronic communications, and guidelines for market analysis and the evaluation of significant market power.

The main characteristics of the Code are as follows:

- redefinition of the concept of significant market power and of the threshold based on which obligations are imposed on certain operators, and the introduction of market analysis;
- the introduction of the term electronic communication services and networks (a broader term which encompasses the term telecommunications );
- electronic communication services and networks can be provided pursuant to a general authorization ;
- more flexibility by national regulatory authorities to select which access and interconnection obligations to impose on operators identified as having significant market power in the market; and
- redefinition of certain measures relating to retail price regulation and the provision of number portability to mobile operators.

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The EU Directives (and other EU-related regulatory interpretations and recommendations) as implemented by the Code provide guidelines on market analysis and the calculation of significant market power and identify 18 markets at retail and wholesale level where such analyses and identification have to be conducted. According to the Code, the Italian National Regulatory Authority is responsible for the evaluation of those operators with significant market power and must propose applicable remedies. The market analyses for seven markets have been published and the process for the remaining eleven markets is expected to be completed by July 2006.

Under the authority afforded by EU law, the Code also provides for the following:

- allows trading in the rights of use of frequencies among operators offering the same type of services;
- excludes directory information services from the category of universal service (and its related obligations);
- provides for specific and more defined rules aimed at reducing the burden of current legislation and local regulations which discipline the installation of networks; and
- redefines the assignment of roles and responsibilities of the Italian Ministry of Communications and the Italian National Regulatory Authority: mainly assigning the task of supervising the authorization process and compliance with the universal service obligations to the Ministry of Communications, and the task of conducting market analyses and proposing remedies to the Italian National Regulatory Authority.

**NOTE 3 ACCOUNTING POLICIES**

**CONSOLIDATION**

The consolidated financial statements include the financial statements of all subsidiaries from when control over such subsidiaries commences until the date that control ceases.

Control exists when the Group has the majority of voting rights or has the power, directly or indirectly, to determine, also through contractual agreements, the financial and operating policies of an enterprise so as to obtain benefits from its activities.

In the preparation of the consolidated financial statements assets, liabilities, revenues and expenses of the consolidated companies are consolidated on a line-by-line basis and minority shareholders' interests in Shareholders' equity and in the net result for the period are disclosed separately in consolidated shareholders' equity and the consolidated statement of operations, respectively.

The amount of investment in each subsidiary is eliminated against the corresponding portion of equity in each subsidiary, after adjustment, if any, of fair values at the acquisition date. Any resulting difference is treated as goodwill and accounted for in accordance with IFRS 3, as discussed below.

All intra-group balances and transactions, and unrealized gains and losses arising from intra-group transactions, are eliminated on consolidation.

The assets and liabilities of foreign consolidated subsidiaries are translated in euro using the exchange rates in effect at the balance sheet date (the current method). Income and expenses are translated at the average exchange rate for the year. Translation differences which arise as a result of this method are classified as equity until the disposal of the investment. The average exchange rates for the year are used to translate the cash flows of foreign subsidiaries included in the consolidated statement of cash flows.

With reference to subsidiaries and associates which adopt inflation accounting to eliminate distorting effects on the result of the year, the statement of operations items have been translated at the year end exchange rates, in accordance with IAS 29 (Financial Reporting in hyperinflationary economies).

In the context of IFRS First-time adoption, the cumulative translation differences arising from the consolidation of foreign subsidiaries was set at nil, as allowed by IFRS 1 (First time Adoption of International Financial Reporting Standards); therefore, only accumulated translation differences generated and recorded after January 1, 2004 are included in the determination of gains or losses arising from the disposal of such foreign subsidiaries, if any.

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Goodwill and fair value adjustments arising from the allocation of the purchase price of a foreign entity are recorded in the relevant foreign currency and are translated using the year-end exchange rate.

If losses attributable to minority shareholders in a consolidated subsidiary exceed the minority interests in the subsidiary's equity, the excess, and any further losses attributable to the minority shareholders, are attributed to the Group except to the extent that the minority shareholders have a binding obligation, and are able, to make an additional investment to cover the losses. If the subsidiary subsequently reports profits, such profits are allocated to the majority shareholders (Group) until the minority's share of losses previously absorbed by the Group has been recovered.

Investments in associates and in jointly controlled companies are included in the consolidated financial statements under the equity method in accordance with IAS 28 (*Investments in Associates*) and IAS 31 (*Interests in Joint Ventures*). Associates are enterprises in which the Group holds at least 20% of the voting rights or exercises a significant influence, but has no control or joint control over the financial and operating policies.

The consolidated financial statements include the Group's share in the earnings of associated and jointly controlled companies on an equity method basis, from the date that significant influence commences until such influence ceases. When the Group's share of losses of an associated and jointly controlled company, if any, exceeds the carrying amount of the related investment on the Group's balance sheet, the carrying amount of the investment is reduced to zero and further losses are not recognized except to the extent that the Group has an obligation to cover such losses.

Unrealized gains and losses arising from transactions with associated companies are eliminated to the extent of the Group's interest in those entities.

The accounting treatment of intra-group transfers of shares of consolidated companies which result in changes in the percentage of ownership of the subsidiary, whose shares are transferred, is not dealt with by IFRS. In the consolidated financial statements, the Group accounts for such transactions at historical values. Such transactions have no impact on the consolidated statement of operations and total shareholders' equity. The gains or losses realized by the sellers are eliminated in full from the consolidated statements of operations and the minority interest is adjusted with a corresponding amount being recorded in the reserves of the Group in order to reflect the change.

**INTANGIBLE ASSETS**

*Goodwill*

When the Group acquires a controlling interest in an entity or business, the identifiable assets, liabilities and contingent liabilities acquired (including minority interests) are recorded at fair value at the date of acquisition. The excess of the cost of the business combination and the Group's interest in the fair value of assets and liabilities is classified as goodwill and recorded in the balance



sheet as an intangible asset with an indefinite life. The excess of fair value over cost or badwill is recognized in the statement of operations at the date of acquisition.

In the absence of a specific Standard or Interpretation, when the Group acquires a minority interest in controlled companies the excess of the acquisition cost over the carrying value of assets and liabilities acquired is recognized as goodwill (Parent entity extension method).

Goodwill is originally recorded at cost and is subsequently reduced by impairment losses.

In accordance with IAS 36 (*Impairment of Assets*), goodwill is tested for impairment annually or more frequently if specific events or changes in circumstances indicate that the goodwill may be impaired. Impairment losses of goodwill are not reversed.

For the purpose of the first-time adoption of IFRS, the Group elected not to apply IFRS 3 (*Business Combinations*) retrospectively to business combinations which occurred prior to January 1, 2004. As a result, goodwill arising on acquisitions before the date of transition to IFRS has been retained at the previous Italian GAAP amounts, and was tested for impairment at the transition date.

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*Research and development costs*

Research costs are charged to the statement of operations in the period in which they are incurred.

Costs incurred internally for the development of new products and services represent intangible assets (mainly costs for software development) or tangible assets. Such costs are capitalized only if all the following conditions are met: the project is technically feasible and the Group intends to complete the asset and make it available for internal use or sale; the ability of the Group to use or sell the asset; the existence of a market for the products or services provided by the asset or the ability to use the asset internally; the availability of adequate technical and financial resources to complete the development and sale or internal use of the asset; and the ability of the Group to measure reliably the cost of the asset during the development phase.

Capitalized development costs comprise only expenditures that can be attributed directly to the development process.

Capitalized development costs are amortized on a systematic basis from the start of production over the estimated product or service life.

*Other intangible assets*

Other purchased or internally-generated intangible assets are recognized as assets in accordance with IAS 38 (*Intangible assets*), where it is probable that the use of the asset will generate future economic benefits and where the cost of the asset can be determined reliably.

Such assets are recorded at purchase or development cost, or, for those assets existing at the transition date (January 1, 2004), at the deemed cost which for certain assets is the revalued cost, and amortized on a straight-line basis over their estimated useful lives, if these assets have finite useful lives. Intangible assets with indefinite useful lives are not amortized, but tested for impairment annually or more frequently, whenever there is an indication that the asset may be impaired.

Amortization is calculated on a straight-line basis over the estimated useful life of the assets. Amortization rates are revised on a yearly basis and change if the current estimated useful life is different from that previously estimated. The effects of changes in useful lives are recognized in the statement of operations prospectively.

**PROPERTY, PLANT AND EQUIPMENT OWNED**

Property, plant and equipment owned are stated at acquisition or production cost or, for those assets existing at the transition date (January 1, 2004), at the deemed cost which for some assets is the revalued cost. Subsequent expenditures are capitalized only if they increase the future economic benefits embodied in the related item of property, plant and equipment. All other expenditures (including interest expenses directly attributable to the acquisition or construction of the asset) are expensed as incurred.

Capitalized cost also includes the present value of expected costs of decommissioning the asset and restoring the location if a legal or constructive obligation exists. The corresponding present value of the liability is recognized, in the year in which the obligation arises, in a balance sheet provision in *Reserve for risks and future charges*. These capitalized costs are depreciated and charged to the statement of operations over the economic useful life of the related tangible assets.

Depreciation of property, plant and equipment owned is calculated on a straight-line basis over the estimated useful life of the assets, as follows:

|  | <b>Depreciation Rates</b> |
|--|---------------------------|
| Civil and industrial buildings           | 3%-7%                     |
| Plant and equipment                      | 3%-33%                    |
| Manufacturing and distribution equipment | 15%-25%                   |
| Ships                                    | 9%                        |
| Other                                    | 12%-25%                   |

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These depreciation rates are reviewed on a yearly basis and are modified if the current estimated useful life is different from that previously estimated. The effects of a change in the useful economic life are recognized in the statement of operations prospectively.

Land, including the land element of buildings, is not depreciated.

**ASSETS HELD UNDER FINANCE LEASES**

Assets held under finance leases, of which the Group retains substantially all the risks and rewards of ownership, are recognized as assets of the Group at their fair value or, if lower, at the present value of the minimum lease payments, including bargain purchase options. The amount due to the lessor is included in the balance sheet as financial debt.

Gains realized on sale and lease-back transactions which are recorded under the finance method in accordance with IAS 17 are deferred over the period of the lease contract.

Assets held under finance leases are depreciated over the shorter of the lease term and their economic useful lives.

Leases where the lessor retains substantially all the risks and rewards of ownership of the assets are accounted for as operating leases. Operating lease rents are charged to the statement of operations on a straight line basis over the lease terms.

**IMPAIRMENT OF ASSETS**

*Assets with a finite life*

During the year, the Group assesses whether there are any indicators of impairment of tangible assets and intangible assets with a finite life. Both internal and external sources of information are used for this purpose. Internal sources include obsolescence or physical damage, and significant changes in the use of the asset and the economic performance of the asset compared to estimated performance. External sources include the market value of the asset, changes in technology, markets or laws, increases in market interest rates and the cost of capital used to evaluate investments, and an excess of the carrying amount of the net assets of the Group over market capitalization.

The recoverable amount of an asset is the higher of fair value less costs to sell and the value in use. In assessing its value in use, the pre-tax estimated future cash flows are discounted to their present value using a pre-tax discount rate that based on current market interest rates 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.

When the conditions that gave rise to an impairment loss no longer exist, the carrying amount of the asset or cash-generating unit is increased to the revised estimate of its recoverable amount, up to the carrying amount that would have been recorded had no impairment loss been recognized. A reversal of an impairment loss is recognized as income in the statement of operations.

*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. Therefore, the date of testing is the year-end closing date of the financial statements. Goodwill acquired and allocated during the year is tested for impairment by 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 cash-generating units or groups of cash-generating units which is 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*).

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If the carrying amount of the cash-generating unit (or group of cash-generating 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 proportionally applied to the carrying amount of the other assets of the cash-generating unit, up to the recoverable amount of the assets. The recoverable amount of a cash-generating unit, or group of units, to which goodwill is allocated, is the higher of fair value less costs to sell and its value in use.

In calculating value in use, the pre-tax estimated future cash flows are discounted to present value using a pre-tax discount rate that reflects current market interest rates and the risks specific to the asset. The future cash flows are derived from the company plans approved by the Board of Directors which generally cover a period of three years, except where longer-term projections are required such as in the case of start-up activities. The long-term growth rate used to estimate the terminal value of the cash-generating unit (or group of cash-generating units) is estimated not higher than the average long-term growth rate of the segment, country or market in which the cash-generating unit (or group of cash-generating units) operate.

The value in use of cash-generating units which operate in a foreign currency is estimated in the local currency by discounting cashflows to present value on the basis of an appropriate rate for that currency. The present value obtained is translated to euro at the spot rate on the date of the impairment test (in the case of the Telecom Italia Group, the date of the financial statements).

Future cash flows are estimated with reference to the current operating conditions of the cash-generating unit and, therefore, do not include either benefits originating from future restructuring for which the entity is not yet committed, or future investments for the improvement or optimization of the cash-generating unit.

For the purpose of calculating impairment, the carrying amount of the cash-generating unit is established based on the same criteria used to determine the recoverable amount of the cash-generating unit, excluding surplus assets (that is, financial assets, deferred tax assets and net assets held for sale) and includes the goodwill attributable to minority interests.

After conducting the goodwill impairment test for the cash-generating unit (or group of cash-generating units), a second level of impairment testing is carried out which includes the corporate assets which do not generate positive cash flows and which cannot be allocated by a reasonable and consistent criteria to the single units. At this second level, the total recoverable amount of all cash-generating units or groups of cash-generating units is compared to the carrying amount of all cash-generating units (or groups of cash-generating units), including also the net assets of those cash-generating units to which no goodwill was allocated and the corporate assets.

**FINANCIAL INSTRUMENTS**

For the purpose of first- time adoption of IFRS, the Group elected to adopt of IAS 32 (*Financial instruments: disclosure and presentation*) and IAS 39 (*Financial instruments: recognition and measurement*) at January 1, 2004, instead of applying the standard for the year beginning January 1, 2005. As allowed by IFRS 1, the designation of financial instruments as a financial asset at fair value through profit or loss or available for sale and as a financial liability valued at fair value through profit or loss has been

carried out at the transition date (January 1, 2004) and not at the date of initial recognition.

As permitted by IFRS 1, where certain non-derivative financial assets and/or liabilities relating to transactions prior to January 1, 2004 have been derecognized under previous accounting policies, those assets and/or liabilities have not been recognized and recorded in accordance with IAS 39, except in circumstances where the information needed to apply IAS 39 to assets and/or liabilities derecognized in the past was available at the time of initially accounting for those transactions. The Telecom Italia Group has taken advantage of such option and is applying the derecognition of non-derivative financial assets/liabilities prospectively from January 1, 2003. As a consequence, the accounts receivables sold and derecognized during 2003 which did not meet the conditions under IAS 39 for derecognition have been accounted for as assets and a corresponding financial liability established.

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*Equity investments*

Equity investments other than those in subsidiaries, joint ventures and associates (normally below 20% shareholding levels) are classified upon the acquisition as assets available for sale or assets valued at fair value through profit or loss and included in current or non current assets.

Such investments are valued at fair value or at cost in the case of unlisted companies or investments whose fair value cannot be determined reliably, adjusted for impairment losses, as required by IAS 39.

Changes in the fair value of equity investments classified as available for sale are recognized in a specific equity reserve until the financial asset is disposed of or impaired; at that moment accumulated gains and losses are reversed to the statement of operations for the year.

Changes in the fair value of equity investments classified as assets valued at fair value through profit or loss are directly recognized in the statement of operations.

*Securities other than equity investments*

Securities other than equity investments classified as non current assets are those held to maturity. The assets are recorded on the trade date and, on initial recognition, are measured at acquisition cost (which generally coincides with fair value), including transaction costs. Subsequently, they are measured at amortized cost.

Under the amortized cost method, the difference between initial cost of the financial instrument, net of repayments of principal already received, and the amount to be received on maturity is recognized each period until maturity based on the effective interest rate method. Write downs are booked for impairment, or uncollectability.

Securities other than equity investments classified as current assets are included in the following categories:

- held to maturity: measured at amortized cost;
- held for trading: measured at fair value through profit or loss;



- available for sale: measured at fair value with the relevant contra items classified in a specific equity reserve.

When market prices are not available, the fair value of financial instruments is measured using appropriate valuation techniques e.g. discounted cash flow based on market information available at the balance sheet date.

The increase/decrease in the value of securities other than equity investments classified as available for sale is directly recognized in a specific equity reserve (*Reserve for fair value adjustments of available for sale financial assets*) until the financial asset is disposed of or impaired; at that moment accumulated gains and losses are reversed to the statement of operations for the year.

#### *Receivables and Loans*

Receivables and loans classified both as non-current and current assets are measured at amortized cost.

Receivables with maturities of over one year which bear no interest or an interest rate significantly lower than market rates are discounted using market rates.

#### *Cash and cash equivalents*

Cash and cash equivalents are recorded, according to their nature, at nominal value or amortized cost.

Cash equivalents are short-term and highly liquid investments that are readily convertible to known amounts of cash, are subject to an insignificant risk of changes in value, and whose original maturity or the remaining maturity at the date of purchase does not exceed 3 months.

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*Impairment of financial assets*

Assessments are made regularly as to whether there is any objective evidence that a financial asset or a group of financial assets may be impaired. If any such evidence exists, an impairment loss is recognized in the statement of operations for the year.

*Financial liabilities*

Financial liabilities include financial debt (including advances received on the assignment of accounts receivable), other financial liabilities such as derivatives and financial lease obligations, and trade payables.

Financial liabilities other than derivatives are initially recognized at fair value less transaction costs and are subsequently measured at amortized cost. The amortized cost is represented by the initial amount of the financial instrument net of repayments of principal already made, adjusted (up or down) on the basis of the amortization (using the effective interest method) of any differences between the initial amount and the maturity amount.

Compound financial instruments represented by 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 (*Other equity instruments*).

Compound financial instruments represented by bonds exchangeable with shares of entities other than the issuer (exchangeable bonds) are recognized by bifurcating the debt and the call option: the debt is recognized included in financial liabilities under the amortized cost method while the call option value is classified as a written option among the financial liabilities and measured at fair value. Gains and losses arising from changes in fair value are recognized in the statement of operations at each reporting date.

Financial liabilities hedged by derivative instruments designed to manage exposure to changes in fair value of the liabilities are measured at fair value in accordance with the hedge accounting principles of IAS 39. Gains and losses arising from re-measurement at fair value are recognized in the statement of operations and are offset by the effective portion of the loss or gain arising from re-measurement at fair value of the hedging instrument.

Financial liabilities hedged by derivative instruments designed to manage exposure to variability in cash flows are measured at amortized cost in accordance with the hedge accounting principles of IAS 39.

*Derivative financial instruments*

Derivative financial instruments are used by the Telecom Italia Group to manage its exposure to 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.

In accordance with IAS 39, derivative financial instruments qualify for hedge accounting only when: a) at the inception of the hedge there is formal designation and documentation of the hedging relationship; b) the hedge is expected to be highly effective; c) its effectiveness can be reliably measured; and d) it is highly effective throughout the financial reporting periods for which the hedge is designated.

All derivative financial instruments are measured at fair value in accordance with IAS 39.

When derivative financial instruments qualify for hedge accounting, the following accounting treatment applies:

- *Fair value hedge* Where a derivative financial instrument is designated as a hedge of the exposure to changes in fair value of an asset or liability due to a particular risk, the gain or loss from re-measuring the hedging instrument at fair value is recognized in the statement of operations. The gain or loss on the hedged item attributable to the hedged risk adjusts the carrying amount of the hedged item and is recognized in the statement of operations.
- *Cash flow hedge* Where a derivative financial instrument is designated as a hedge of the exposure to variability in cash flows of an asset or liability or a highly probable forecasted transaction, the effective

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portion of any gain or loss on the derivative financial instrument is recognized directly in a specific equity reserve (*Reserve for fair value adjustments of hedge instruments*). The cumulative gain or loss is removed from equity and recognized in the statement of operations when the hedged transaction is recorded in the statement of operations. The gain or loss associated with the ineffective portion of a hedge is recognized in the statement of operations immediately. When a hedging instrument or hedge relationship is terminated but the hedged transaction is still expected to occur, the cumulative gain or loss remains in the equity reserve and is recognized in the statement of operations when the related transaction occurs or an impairment loss is recorded. If the hedged transaction is no longer probable, the cumulative unrealized gains or losses included in the equity reserve are immediately recognized in the statement of operations.

If hedge accounting is not appropriate, gains or losses arising from the measurement of the fair value of derivative financial instruments are directly recognized in the statement of operations.

**SALES OF RECEIVABLES**

The Telecom Italia Group sells a significant part of its receivables through either securitization programs or factoring transactions.

Telecom Italia regularly sells a portfolio of trade receivables without recourse to the TI Securitization Vehicle S.r.l., a Special Purpose Entity (SPE). This SPE finances the purchase of the receivables by issuing asset-backed securities (i.e. securities whose repayment and interest flow depend upon the cash flow generated by the portfolio of trade receivables). The sales price of the receivables, equal to the nominal value of the receivables less a discount which takes into account the expenses that the vehicle must bear, is paid to Telecom Italia partly as an Advanced Purchase Price (APP), at the time of sale, and partly as a Deferred Purchase Price (DPP). The deferred portion, which constitutes the credit enhancement under the Program, is paid to the assignor each time new receivables are sold, subject to the cash availability of the vehicle, and is calculated by the Program Administrator on the basis of pre-established conservative estimates of the collection times and the amounts of the credit notes that will be issued, consistent with the view of the rating agencies on a AAA or equivalent portfolio. Such estimates, and therefore also the Deferred Purchase Price, are adjusted monthly on the basis of the effective performance of the receivables. For invoices issued and sold through September 2005, with regard to the risk of uncollectability, Telecom Italia was responsible for the ultimate recovery from the debtors on the receivables sold, up to the limit of the amount of the DPP and the SPE retained the risk of uncollected amounts over the DPP. In accordance with SIC 12 (Consolidation *Special Purpose Entities* (SPE)) through September 30, 2005, TI Securitization Vehicle S.r.l. (TISV) was included in the scope of consolidation, because the exposure of the assignor to the risk of uncollectability of the deferred purchase price implied, in substance, control over the SPE.

On December 15, 2005, the securitization program was restructured based on a Master DPP Transfer Agreement signed by Telecom Italia and certain financial institutions under which the DPP on Telecom Italia receivables relating to invoices issued between October 1, 2005 and May 31, 2006, are sold without recourse to such financial institutions.

Following the sale of the DPP without recourse, the risks and rewards of ownership of these receivables have been transferred in full to the financial institutions which take the control of SPE in accordance with SIC-12 provisions and, therefore, consolidate TISV.

The outstanding amount of receivables for DPP not sold at year end is not significant.

In addition, the Telecom Italia Group carried out some factoring transactions with or without recourse. Certain factoring agreements without recourse include deferred purchase price clauses (i.e. the payment of a minority portion of the purchase price is conditional upon the full collection of the receivables), require a first loss guarantee of the seller up to a limited amount, or include a continuing significant exposure to the cash flows arising from the receivables sold. These kinds of transactions do not meet IAS 39 requirements for assets derecognition, since the risks and rewards have not been substantially transferred.

Consequently, all receivables sold through factoring transactions which do not meet IAS 39 derecognition requirements are reflected in the Group financial statements, although they have been legally sold without recourse, and a corresponding financial liability is recorded in the consolidated financial statements.

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**RECEIVABLES FOR CONSTRUCTION CONTRACTS**

Construction contracts, relating to contracts with a duration of both less and more than 12 months, are recognized in accordance with the stage of completion and classified as receivables among current assets. Losses on such contracts, if any, are fully recorded in the statement of operations when they become known.

**INVENTORY**

Inventories of raw materials, semi-finished goods, work in progress and finished goods are valued at the lower of cost or market, cost being determined on a weighted average cost of each purchase. The inventory value includes the direct costs of materials, labor and indirect production costs (variable and fixed). Provision is made for obsolete and slow-moving raw materials, finished goods, spare parts and other supplies based on their expected future use and realizable value.

**DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE**

Discontinued operations/assets held for sale include assets (or groups of assets to be disposed of) whose carrying amount will be recovered principally through a sale transaction rather than through continuing use. Assets held for sale are measured at the lower of their carrying amount or fair value less costs of disposal.

In accordance with IFRS, discontinued operations/assets held for sale are presented as follows in the statement of operations and the balance sheets:

- in two lines on the balance sheet: Discontinued operations/assets held for sale and Liabilities relating to discontinued operations/assets held for sale; and
- in one line in the statement of operations: Net income (loss) from discontinued operations/assets held for sale.

**EMPLOYEE BENEFITS**

*Reserve for severance indemnities*

The Reserve for severance indemnities, to be accrued by Italian companies in accordance with the Italian Civil Code, is considered a defined benefit plan and is based, among other things, on employees' years of service and remuneration earned by the employee during a pre-determined service period.

The Reserve for severance indemnities is determined by independent actuaries using the Projected Unit Credit method. For the purpose of first-time adoption of IFRS, and in subsequent years, the Group has elected to recognize all cumulative actuarial gains and losses.

The interest expense related to the discounting of the Reserve for severance indemnities is included in Personnel cost in the statement of operations.

#### *Stock compensation plans*

The Group provides additional benefits to certain members of senior management and employees through stock compensation plans (*stock options*) which are accounted for in accordance with IFRS 2 (*Share-based Payments*).

Employee stock options are measured at fair value at the grant date using models that take account of circumstances applicable at the date of grant (option exercise price, vesting period, current price of the underlying shares, expected share price volatility, expected dividends and interest rate for a risk-free investment over the option term).

If the right vests after a certain period of time and/or upon attainment of certain performance conditions, the total stock option amount must be apportioned pro-rata temporis over the vesting period and recorded in equity under Other equity instruments, with a corresponding amount being recorded in the statement of operations under Personnel cost (given that this is a non-monetary consideration intended to enhance employee loyalty and provide an incentive to improve business performance).

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At the end of each reporting period, the previously determined fair value of each option is not restated or updated, but maintained in equity. However, the Group reviews the estimated number of options that will vest until expiry (and therefore the number of employees who will have exercise rights). The change in estimate must be deducted from or added to Other equity instruments with a corresponding amount being recorded in the statement of operations under Personnel cost.

When the option expires, the amount reflected in Other equity instruments is reclassified as follows: the portion relating to exercised options is reclassified to Additional paid-in capital and the portion relating to non-exercised options is reclassified under Retained earnings (accumulated losses), including net income (loss) for the year.

The Group elected to apply the exemptions provided by paragraph 25B of IFRS 1 and, therefore, did not apply IFRS 2 to stock option plans granted before November 7, 2002, where the terms and conditions of such plans did not change.

**RESERVES FOR RISKS AND FUTURE CHARGES**

The Group records provisions when it has an obligation, legal or constructive, to a third party, when it is probable that an outflow of Group resources will be required to satisfy the obligation and a reliable estimate of the amount can be made.

Changes in estimates are reflected in the statement of operations in the period in which the change occur.

**TREASURY SHARES**

Treasury shares are reported as a deduction from shareholders' equity. In particular, the nominal value of treasury shares is reported as a deduction from the Share capital issued while the excess portion of cost at acquisition over the nominal value is reported as a reduction of Other reserves.

**FOREIGN CURRENCY TRANSACTIONS**

Transactions in foreign currencies are recorded at the foreign exchange rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the foreign exchange rate prevailing at the balance sheet date. Exchange differences arising from the settlement of monetary items or from their conversion at rates different from those at which they were initially recorded during the year or in previous financial statements, are recognized in the statement of operations.



**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 interconnection and roaming are reported gross of the amounts due to other TLC operators.

Revenues from services rendered are recognized with reference to the proportional performance method of the transaction and only when the outcome of the transaction can be estimated reliably. Revenues from the activation of telephone services and 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). Subscriber acquisition and retention costs are recognized in the statement of operations in the year in which they are incurred.

Revenues from construction contracts are recognized based on of the percentage completion method.

**ADVERTISING EXPENSES**

Advertising expenses are charged to the statement of operations as incurred.

**TAXES**

Income taxes include all taxes calculated on the basis of the taxable income of the companies of the Group.

Income taxes are recognized in the statement of operations except to the extent that they relate to items directly charged or credited to equity, in which case the related income tax effect is recognized in equity. Provisions for income taxes that could arise on the remittance of a subsidiary's retained earnings are only made where there is the intention to remit such earnings. Other taxes, other than income taxes, such as property taxes and capital taxes, are included in operating expenses.

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Deferred tax liabilities/assets are provided using the Balance sheet liability method . They are calculated on all temporary differences that arise between the tax base of an asset or liability and the carrying values in the consolidated financial statements except for non tax-deductible goodwill and for those differences related to investments in subsidiaries which will not reverse in the foreseeable future. Deferred income tax assets relating to the carry-forward of unused tax losses and tax credits are recognized to the extent that it is probable that future profits be available against which they can be utilized. Current and deferred income tax assets and liabilities are offset when the income taxes are levied by the same taxing authority and where there is a legally enforceable right of offset. Deferred tax assets and liabilities are determined based on enacted tax rates in the respective jurisdictions in which the Group operates that are expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

**DIVIDENDS**

Dividends payable are reported as a change in shareholders' equity in the year in which they are approved by the shareholders meeting.

**EARNINGS PER SHARE**

Basic earnings per Ordinary Share is calculated by dividing the Group's net income attributable to Ordinary Shares by the weighted average number of Ordinary Shares outstanding during the year, excluding Treasury Shares. Similarly, basic earnings per Saving Share is calculated by dividing the Group's net income attributable to Saving Shares by the weighted average number of Saving Shares outstanding during the year. For diluted earnings per Ordinary Share, the weighted average number of shares outstanding is adjusted assuming conversion of all dilutive potential shares. The Group net income is also adjusted to reflect the impact of the conversion of potential shares net of the related tax effects.

**USE OF ESTIMATES AND JUDGMENTS**

The preparation of consolidated financial statements and related disclosures that conform to IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates. Estimates are used in many areas, including accounting for revenues, bad debt provisions, inventory obsolescence and slow moving, depreciation and amortization, asset impairment, employee benefits, taxes, restructuring reserves, provisions and contingencies. Estimates and assumptions are reviewed periodically and the effects of any changes are reflected immediately in the statement of operations.

In the absence of a Standard or an Interpretation that specifically applies to a transaction, management uses its judgment in developing and applying an accounting policy that results in information that is reliable, in that the financial statements:

- i. represent a true and fair view of the financial position, operating result and cash flows of the entity;

- ii. reflect the economic substance of transactions, other events and conditions, and not merely the legal form;
- iii. are neutral, i.e. free from bias;
- iv. are prudent; and
- v. are complete in all material respects.

**NEW PRINCIPLES AND INTERPRETATIONS ENDORSED BY THE EUROPEAN UNION BUT NON YET EFFECTIVE**

In accordance with IAS 8 (*Accounting Policies, Changes in Estimates and Errors*) when a new Standard or Interpretation has been issued but is not yet effective, this fact and known or reasonably estimable information are to be disclosed to assess the possible impact that application of the new Standard or Interpretation will have on the financial statements in the period of initial application.

The IFRS effective from January 1, 2006 or later are hereby disclosed.

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*Amendments to IAS 19 Employee benefits*

Such amendments, introduced by IASB in December 2004 and endorsed by the European Union in November 2005 (Regulation EC 1910-2005), allow, the option to recognize actuarial gains and losses in full in the period in which they occur, outside the consolidated statements of operations and directly in a specific reserve within shareholders' equity.

The Telecom Italia Group does not intend to use this option as it accounts for all actuarial gains and losses immediately in the statement of operations in the year when they occur. Such amendments are effective commencing January 1, 2006.

*IFRIC 4 Determining whether an arrangement contains a lease*

This interpretation, endorsed by the EU in November 2005 (Regulation EC 1910-2005), states that an arrangement that does not have the legal form of a lease but contains a lease has to be accounted for and classified as a finance or operating lease in accordance with IAS 17 (*Leasing*).

This Interpretation is effective commencing January 1, 2006.

Management not expects that the application of this interpretation will have a material impact on the Group consolidated financial statements.

*Amendments to IAS 39 Cash Flow hedge accounting of forecast intragroup transactions*

This amendment to IAS 39 endorsed in 2005 by the EU (Regulation EC 2106/2005) permits the foreign currency risk of a highly probable intragroup forecast transaction to qualify as the hedged item in cash flow hedge in consolidated financial statements, provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect the consolidated statement of operations.

The amendment is effective commencing January 1, 2006 and will have no impact on the Telecom Italia Group consolidated financial statements.

*IFRIC 6 Liabilities arising from participating in a specific market Waste electrical and electronical equipment*

Following the adoption of the European Union's Directive on Waste Electrical and Electronic Equipment (WE&EE) which regulates the collection, treatment, recovery and environmentally sound disposal of waste equipment, the IFRIC issued Interpretation No. 6 (IFRIC 6) which was endorsed by the EU (Regulation CE 108/2006) in January 2006 and provides guidance on how to recognize, in the financial statements of producers, the liabilities for waste management under the above EU Directive for equipment sold to private households before August 13, 2005 (i.e. historical waste).

IFRIC 6 clarified that participation in the market during the measurement period is the obligating event under IAS 37. As a result, the liability for waste management costs for historical household equipment arises from participation in the market during the measurement period and the timing of the obligating event may also be independent of the particular period in which the activities to perform the waste management are undertaken and the related costs incurred.

This Interpretation is effective commencing 2006. However the Italian Government has not yet issued and approved the necessary decrees to make the Directive effective. As a consequence, in absence of a Regulatory Framework the Group is unable, at the present time, to estimate the impacts, if any, on the financial statements arising from the application of the Interpretation.

*Amendment to IAS 39 and IFRS 4 Financial Guarantee Contracts*

These amendments, endorsed by the EU in January 2006 (regulation EC 108/2006), extend the scope of IAS 39 and provide guidance on the accounting of financial guarantee contracts by the issuer (guarantor).

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However, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting policies applicable to insurance contracts, it may elect to apply either IAS 39 or IFRS 4 (*Insurance Contracts*) to such financial guarantee contracts.

Such amendments are effective from January 1, 2006.

The Telecom Italia Group applies IAS 39 to these contracts and, consequently, no impact is expected from the application of these provisions.

*IFRS 7 Financial instruments disclosures*

This Standard, endorsed by the EU in January 2006 (Regulation EC 108/2006), replaces IAS 30 (*Disclosures in the financial statements of Banks and similar financial institutions*) and includes the Disclosure section of IAS 32 (*Financial instruments: Disclosure and presentation*) with certain amendments and integrations. As a result, IAS 32's title changes to *Financial instruments: Presentation*.

IFRS 7 will be effective from January 1, 2007.

*Amendments to IAS 1 Presentation of Financial Statements Capital Disclosures*

These amendments, endorsed by EU in January 2006 (Regulation EC 108/2006), state that an entity shall disclose information to enable users of its financial statements to evaluate the entity's objectives, policies and process for capital management.

Such amendments will be effective from January 1, 2007.

**NOTE 4 BUSINESS COMBINATIONS, ACQUISITIONS OF MINORITY INTERESTS AND TRANSACTIONS BETWEEN COMPANIES UNDER COMMON CONTROL**

**BUSINESS COMBINATIONS**

**YEAR 2005*****Acquisition of Liberty Surf Group S.A.***

On May 31, 2005, after receiving the clearance by the French Antitrust Authorities, on the Stock Purchase agreements signed in April 2005, the closing of the transaction has taken place between Telecom Italia and Tiscali for the purchase of the equity investment held by the latter in Liberty Surf Group S.A., an important internet service provider operating on the French market. The investment corresponded to a 94.89% stake in the share capital of the company which is listed on the Paris Euronext.

The purchase price was approximately 248 million.

After the closing took place, Telecom Italia, in accordance with the applicable legal requirements, launched two takeover bids followed by a mandatory purchase of the residual capital of Liberty Surf Group S.A. at the price of 2.78 per share for a cost of 14 million.

Following these transactions, Telecom Italia holds 94,074,314 Liberty Surf Group S.A. shares equal to 100% of the capital of Liberty Surf Group S.A., after cancellation of the treasury stock held by Liberty Surf Group S.A., for a total cost of 268 million, including incidental costs of 6 million.

The following table presents the effect of the accounting treatment used for the purchase of the equity investment in Liberty Surf Group S.A.. The difference ( 257 million) between the price paid ( 268 million) and the net assets acquired ( 11 million), excluding pre-existing goodwill ( 34 million), was allocated as follows:

|                    |   |
|--------------------|---|
| • 249 million      | to Goodwill   |
| • 13 million       | to Intangible assets with a finite life Customer List |
| • (5) million      | to Reserve for deferred taxes                         |
| <hr/>              |   |
| <b>257 million</b> |   |
| <hr/>              |   |

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The value of the Customer List has been determined on the basis of the SAC (Subscriber Acquisition Cost) for the customers acquired. The replacement cost method was elected in lieu of the income method because the Tiscali wholesale business generated losses at the date of purchase.

The goodwill arising on acquisition was tested for impairment at the date of purchase, taking into consideration the value in use of the company acquired and also the synergies expected from the integration with Telecom Italia France. No indication of impairment arose.

**Liberty Surf Group S.A.**

|   | <u>Fair values</u> | <u>Book values</u> |
|---|--------------------|--------------------|
|   | (millions of Euro) |                    |
| Goodwill  | 249                | 34                 |
| Other non-current assets (excluding goodwill)                 | 76                 | 63                 |
| Total current assets  | 68                 | 68                 |
| <b>Total assets</b>   | <b>393</b>         | <b>165</b>         |
| Reserve for deferred taxes                                    | 5                  |                    |
| Other non-current liabilities                                 | 21                 | 21                 |
| Total current liabilities                                     | 99                 | 99                 |
| <b>Total liabilities</b>                                      | <b>125</b>         | <b>120</b>         |
| <b>Net assets acquired</b>                                    | <b>(*)268</b>      | <b>45</b>          |
| <i>(*) Of which:</i>  |                    |                    |
| <i>Cost of the equity investment</i>                          | 262                |                    |
| <i>Ancillary costs (taxes, legal fees and other expenses)</i> | 6                  |                    |
| <b>Total acquisition cost</b>                                 | <b>268</b>         |                    |

The effect of the acquisition of Liberty Surf Group on the 2005 statement of operations is not significant the impact on the net financial position is to increase debt by 259 million ( 268 million for the price paid net of 9 million of cash and cash equivalents acquired).

**Acquisition of Elefante TV and Delta TV**



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On October 28, 2005 and November 4, 2005, after the necessary authorizations were received, the deeds were finalized for the purchase of Elefante TV and Delta TV for 116 million and 12 million, respectively.

Overall, the television broadcasting frequencies acquired represent a coverage of approximately 70% of the Italian population and will allow Telecom Italia Media to extend both its analog and digital TV broadcasting capabilities.

The transaction was carried out by the contribution of Elefante TV and Delta TV's business segments to Telecom Italia Media Broadcasting in exchange for stock and, simultaneously, the sale to LA7 Televisioni of the shares issued by Telecom Italia Media Broadcasting following the contribution.

The business segments acquired include all the assets and operations functionally required for conducting TV broadcasting business, such as the stations and the frequencies, the Elefante TV brandname, the plant, equipment and sundry instruments, antennas, radio links, relay stations and other assets connected with radio and television operations using analog or digital technology. Also contributed were the contracts for the housing and maintenance of the equipment for radio and TV broadcasting and all the rights, permits, licenses, concessions (including the concession issued by the Ministry of Communications on July 28, 1999), relative to this business.

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The following table presents the effect of the accounting treatment used for the purchase of the business segments.

- 41 million to Goodwill
- 126 million to Intangible assets with a finite life Station Frequencies and TV Station Rights
- (41) million to Reserve for deferred taxes

---

**126million**

---

**Elefante TV and Delta TV**

|   | <u>Fair values</u> | <u>Book values</u> |
|---|--------------------|--------------------|
|   | (millions of Euro) |                    |
| Goodwill  | 41                 |                    |
| Station frequencies   | 114                |                    |
| Television station rights                                     | 12                 |                    |
| Other assets  | 3                  | 3                  |
| <b>Total assets</b>   | <b>170</b>         | <b>3</b>           |
| Payables and other liabilities                                | 1                  | 1                  |
| Reserves for deferred tax assets                              | 41                 |                    |
| <b>Total liabilities</b>                                      | <b>42</b>          | <b>1</b>           |
| <b>Net assets acquired</b>                                    | <b>(*)128</b>      | <b>2</b>           |
| <i>(*) Of which:</i>  |                    |                    |
| <i>Cost of business segments</i>                              | <i>127</i>         |                    |
| <i>Ancillary costs (taxes, legal fees and other expenses)</i> | <i>1</i>           |                    |
| <b>Total acquisition cost</b>                                 | <b>128</b>         |                    |

**ACQUISITIONS OF MINORITY INTERESTS****YEAR 2004****Acquisition of a 40% stake in Finanziaria Web**

At the end of June 2004, an agreement was reached to settle the dispute concerning the framework agreement signed on September 20, 2000 between Seat Pagine Gialle S.p.A. (now Telecom Italia Media) and its subsidiaries, and the companies in the De Agostini group.

Based on the agreement, De Agostini Invest transferred the entire investment held in Finanziaria Web to Telecom Italia Media (which already had control of the company with a 60% holding) for cash consideration of 287 million, in lieu of the originally agreed price of 700 million.

In addition to this amount, 38 million was paid to reimburse De Agostini Invest for the amounts paid to cover losses and recapitalize Finanziaria Web since July 2001.

The effect on the statement of operations of the Telecom Italia Group was an impairment loss of 116 million net of taxes.

***Acquisition of Corporacion Digitel shares***

With regard to the numerous disputes pending between TIM International and the other shareholders in Corporacion Digitel, related to the coverage of the losses incurred in 2002, a settlement agreement was reached in April 2004 wherein TIM International agreed to purchase all the other shareholders stakes (corresponding to 32.88% of Corporacion Digitel s share capital).

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According to the agreement, executed on July 1, 2004, TIM International purchased 1,480,562 shares held by the minority shareholders of the Venezuelan company for U.S.\$109.6 million. The closing took place after verification of the contractual conditions put into place to protect TIM International and Corporacion Digital.

As a result, since July 1, 2004, TIM International holds 100% of the shares of the Venezuelan mobile operator.

**YEAR 2005*****Telecom Italia/TIM merger***

The merger of Telecom Italia and TIM, described in detail in Item 4. Information on the Telecom Italia Group 4.1 Business 4.1.3 Significant developments during 2005 , was finalized on June 30, 2005.

In summary, the merger was executed by the following transactions:

- Cash tender offer for TIM ordinary and savings shares and additional purchases of TIM shares, detailed as follows:

|  |                           |
|--|---------------------------|
| No. 2,456,501,605 ordinary shares acquired in the cash tender offer for  | 13,854 million            |
| No. 8,463,127 savings shares acquired in the cash tender offer for       | 48 million                |
| No. 5,063,893 additional purchases of ordinary and savings shares for    | 28 million                |
| <b>Total No. 2,470,028,625 ordinary and savings shares purchased for</b> | <b>(1) 13,930 million</b> |

(1) Including 98 million of costs incurred for the tender offer.

- Telecom Italia Share capital increase to effect the merger by the issue of:

|  |                      |
|--|----------------------|
| No. 2,150,947,060 Ordinary Shares ( 2.595 per share) for   | 5,582 million        |
| <b>less:</b> No. 24,607,520 shares issued by Telecom Italia to be issued in exchange for   |                      |
| No. 14,224,000 TIM shares held by Telecom Italia Finance ( 2.595 per share) for  | (64) million         |
| No. 230,199,592 Savings Shares ( 2.156 per share) for  | 496 million          |
| <b>Total No. 2,356,539,132 Ordinary and Savings Shares issued, net of No. 24,607,520 shares issued to effect the exchange for No. 14,224,000 TIM shares held by Telecom Italia Finance, for a total of</b> | <b>6,014 million</b> |

The Telecom Italia/TIM merger was accounted for at fair value applying the parent-entity extension method. The difference between the fair value of the shares purchased and issued, and the underlying share of TIM's carrying value of net assets acquired was recorded as goodwill and amounted to 16,654 million, of which 11,804 million arose from the cash tender offer and additional share purchases, and 4,850 million from the exchange of TIM shares. The Telecom Italia shares issued to service the exchange were valued at the market price at June 30, 2005 ( 2.595 for each Ordinary Share and 2.156 for each Savings Share).

***Reorganization of the Brazilian mobile telephone companies***

On May 30, 2005, the Extraordinary Shareholders' Meetings of the three companies involved unanimously approved the acquisition of the shares of the minority shareholders of TIM Sul S.A. and TIM Nordeste Telecomunicações S.A. by means of a share capital increase by TIM Participações S.A.. The exchange ratios were determined on the basis of economic and equity valuations performed by Banco ABN-AMRO Real S.A.. TIM Participações affected a capital increase on behalf of the shareholders of the two subsidiaries by issuing ordinary and preferred Shares. On the same date, TIM Sul S.A. and TIM Nordeste Participações S.A. were delisted from the Brazilian stock exchange and TIM Participações then cancelled the shares purchased from the shareholders which exercised their withdrawal rights. The two companies, although maintaining separate legal and administrative status, are now wholly-owned subsidiaries of TIM Participações.

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The effect on goodwill is as follows:

- an increase of 62 million for the purchase of the shares of the minority shareholders of TIM Sul S.A. and TIM Nordeste Telecomunicações S.A. through the capital increase reserved to them and effected by the parent TIM Participações S.A. ( 57 million) and 5 million for the purchase of TIM Participações S.A. ordinary shares on the market by the subsidiary TIM Brasil;
- a decrease of 25 million for the derecognition of goodwill as a result of the dilution of the investment in TIM Participações S.A. following the capital increase reserved to the minority shareholders.

The goodwill of 57 million is calculated as the difference between the market value of ordinary and preferred shares issued by TIM Participações and subscribed by the minority shareholders of TIM Sul and TIM Nordeste Telecomunicações ( 204 million) and the underlying share of the net assets attributable to the minority interests of TIM Sul and TIM Nordeste Telecomunicações at the time of the transaction and covered by the acquisition ( 147 million).

The transaction had a negative effect of 14 million on the Shareholders' equity attributable to the Group and a positive effect of 40 million on the minority interests.

**TRANSACTIONS BETWEEN COMPANIES UNDER COMMON CONTROL**

***Acquisition of Virgilio and Tin.it by Telecom Italia S.p.A.***

As part of the process to rationalize the Telecom Italia Group's Internet operations, the following transactions were finalized on the basis of the contractual agreements signed with Telecom Italia Media on April 4, 2005:

- on May 30, 2005, Telecom Italia purchased, from Telecom Italia Finance, the entire investment in ISM S.r.l. (which already held a 40% stake in Finanziaria Web which, in turn, held a 66% interest in Matrix) for a total amount of 98 million;
- on June 1, 2005, ISM S.r.l. (in which Telecom Italia holds a 100% interest), having received 70 million from Telecom Italia in the form of an increase in share capital, acquired 60% of Finanziaria Web and 0.7% of Matrix from Telecom Italia Media for 70 million;
- on June 1, 2005, Telecom Italia purchased the 100% interest in Nuova Tin.it S.r.l., a newly-established company in which Telecom Italia Media contributed the Tin.it business segment, at a price of 880 million.

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At the conclusion of the foregoing transactions, Telecom Italia holds, directly and indirectly, (through ISM) full control over Virgilio's operations.

The purchase of the Internet business from the subsidiary Telecom Italia Media is considered a transaction among shareholders since it took place within the same group. Accordingly, the difference between the price paid and the share of underlying net assets acquired of 364 million was allocated as a reduction of reserves.

On June 28, 2005, the buyback of ordinary and savings shares was successfully concluded for, respectively, 0.40 per ordinary share and 0.33 per savings share, as voted by the Shareholders Meeting of Telecom Italia Media held May 24, 2005.

Telecom Italia Media, after proportionally allocating the shares tendered, bought back 364,251,922 ordinary shares and 6,107,723 savings shares for a total of 148 million.

Following the cancellation of the shares bought back on October 18, 2005, Telecom Italia increased its direct controlling interest (60.2%) and indirect holding (2.1% through Telecom Italia Finance) from a total of 62.3% to 69.2%. The percentage investment in share capital, also taking into account the exercise of stock options, increased from 61.47% to 68.07% at December 31, 2005.

### ***Reorganization of the Med group***

In July 2005, the Telecom Italia Group executed the agreement reached last December with the minority shareholders of Med Nautilus S.A., Med Nautilus Ltd and Med 1, negotiated to resolve certain matters disputed

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under Med Nautilus S.A. s and Telecom Italia/Telecom Italia International s put option on 49% of Med Nautilus Ltd and Med 1 shares, and to resolve the arbitration proceedings set in motion in Luxembourg by the Fishman group (FTT) aimed at the restitution of the amounts paid to Telecom Italia International in 2000 for the purchase of a 30% stake in Med Nautilus S.A..

As a result of this agreement, the Telecom Italia Group, besides strengthening its presence in the sector of IP services and wholesale data in the East Mediterranean, now holds a 100% stake in Med Nautilus Ltd (through Med Nautilus S.A.) and in Med 1, following the purchase of the minority interest for consideration of 135 million.

Concurrently, non-strategic activities in certain local Israeli operations were sold, which were managed by the same Med Nautilus Ltd and Med 1 (for the latter, the entire investment in Med 1 IC-1 (1999) Ltd was sold). Furthermore, the Fishman group, in disposing of its investment in Med Nautilus S.A., acquired 30% of the capital of the subsidiary Elettra S.p.A. for approximately 35 million.

Overall, the agreement entailed a net cash disbursement of 49 million.

**NOTE 5 FINANCIAL RISK MANAGEMENT**

***Objectives and policies for the management of the financial risks of the Telecom Italia Group***

The Telecom Italia Group is exposed to market risks in the ordinary course of its business operations. Such risks are mainly interest rate and exchange rate exposure in connection with financial assets acquired and financial liabilities assumed. These principally include short-term and medium-term bank loans, ordinary and convertible bonds, finance leases, financial assets represented by securities, and trade accounts receivable and payable.

Market risks are managed by:

- the definition, at a central level, of guidelines for operations;
- the activities of an internal committee which monitors the level of exposure to market risks consistently with predetermined general objectives;
- the identification of the most suitable financial instruments, including derivatives, to attain the predetermined objectives;



- the monitoring of actual results; and
- the exclusion of any dealings with speculative financial instruments.

The monitoring activities conducted by the central treasury function and the internal committee are also aimed at assessing, on an ongoing basis, the creditworthiness of counterparties and the concentration of risk.

***Market risk***

The risk management policies of the Telecom Italia Group aim at diversifying market risks and minimizing interest rate exposure by suitable portfolio diversification, which is also implemented by using carefully selected derivative financial instruments.

The Telecom Italia Group is exposed to market risks as a result of changes in interest rates and in exchange rates in the markets in which the Group operates mainly Europe, Great Britain, the United States and Latin America.

The Group defines an optimum fixed-rate and floating-rate debt composition and uses derivative financial instruments to achieve that predetermined mix. Interest Rate Swaps (IRS), in particular, are used to modify the profile of the original exposure to interest rate risks on loans and bonds, whether fixed or floating, to bring them in line with parameters that are considered optimum.

Taking into account the Group's operations in various sectors, in terms of risk, volatility and the amount of anticipated operating cash flows, the optimum blend of medium/long-term non-current financial liabilities has been established at 70% fixed-rate and 30% floating-rate. These percentages are established on the nominal amount of the debt.

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Cross Currency and Interest Rate Swaps (CCIRS) and Currency Forwards are used to convert loans and bonds issued in currencies other than the euro principally in U.S. dollars and British pounds to the functional currencies of the operating companies.

As a result of the above policies, at December 31, 2005, the exchange risk on the financial payables of the Group denominated in currencies other than euro was completely hedged.

Derivative financial instruments are used by the Group and are designated as fair value hedges for the management of exchange rate risk on instruments denominated in currencies other than the euro and the management of the interest rate risk on fixed-rate debt. Derivative financial instrument are designated as cash flow hedges when the objective is to fix the exchange rate of future transactions and the interest rate.

All derivative financial instruments are put into place with high-credit-quality banking and financial counterparties and are constantly monitored in order to reduce the credit risk.

The following tables present the nominal repayment/investment amount that reflects the effective interest rate exposure of the Group and, as far as financial assets are concerned, account was taken of the intrinsic nature of the transactions under consideration (financial characteristics and duration) rather than the stated contractual terms alone. Bearing that in mind, a transaction whose characteristics (short or very short time frame, frequent renewal) are such that the interest rate is periodically re-fixed on the basis of market parameters, even though the contract does not call for the re-fixing of the interest rate (such as in the case of bank deposits and Euro Commercial Paper), was considered in the category of floating rate.

The information below does not include in Financial liabilities related to discontinued operations/assets held for sale payables of Corporacion Digitel ( 11 million of non-current liabilities) and the Gruppo Buffetti ( 19 million of current liabilities) due to Group companies and consequently, does not include accounts receivable due from Group companies to Corporacion Digitel and the Gruppo Buffetti.

**Financial liabilities (at nominal repayment amount)**

|  | <b>Fixed rate<br/>debt</b> | <b>Floating rate<br/>debt</b> | <b>Total</b>  |
|--|----------------------------|-------------------------------|---------------|
|  | (millions of Euro)         |                               |               |
| Notes and bonds                              | 24,511                     | 10,066                        | 34,577        |
| Convertible/exchangeable notes and bonds     | 2,642                      |                               | 2,642         |
| Loans and other payables                     | 5,434                      | 7,644                         | 13,078        |
| Discontinued Operations/assets held for sale |                            | 112                           | 112           |
| <b>Total</b>                                 | <b>32,587</b>              | <b>17,822</b>                 | <b>50,409</b> |

**Financial assets (at the nominal investment amount)**

|  | <b>Fixed rate<br/>assets</b> | <b>Floating rate<br/>assets</b> | <b>Total</b>  |
|--|------------------------------|---------------------------------|---------------|
|  |                              | (millions of Euro)              |               |
| Deposits and cash                            |                              | 10,041                          | 10,041        |
| Euro commercial papers                       |                              | 326                             | 326           |
| Securities                                   | 4                            | 380                             | 384           |
| Other receivables                            | 24                           | 1,038                           | 1,062         |
| Discontinued Operations/assets held for sale |                              | 37                              | 37            |
| <b>Total</b>                                 | <b>28</b>                    | <b>11,822</b>                   | <b>11,850</b> |

For floating-rate financial instruments, the contracts provide for revisions of the relative parameters to take place within the next 12 months.

For the effective interest rate table, the amount of assets and liabilities includes the original transaction net of the effect of any derivative hedge instruments.

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The information, since it is provided by class of financial assets and liabilities, was established under an average weighting method using the **adjusted book value** related to accruals and fair value adjustments. Therefore, this represents the amortized cost, net of accruals and any fair value adjustments as a consequence of hedge accounting.

**Financial liabilities**

|  | <b>Adjusted<br/>book value</b> | <b>Effective<br/>interest rate</b> |
|--|--------------------------------|------------------------------------|
|  | (millions of Euro)             | (%)                                |
| Notes and bonds                          | 34,453                         | 5.71%                              |
| Convertible/exchangeable notes and bonds | 2,505                          | 6.39%                              |
| Loans and other payables                 | 12,891                         | 3.93%                              |
| <b>Total</b>                             | <b>49,849</b>                  | <b>5.28%</b>                       |

**Financial assets**

|                        | <b>Adjusted<br/>book value</b> | <b>Effective<br/>interest rate</b> |
|------------------------|--------------------------------|------------------------------------|
|                        | (millions of Euro)             | (%)                                |
| Deposits and cash      | 10,041                         | 3.03%                              |
| Euro commercial papers | 326                            | 2.36%                              |
| Securities             | 384                            | 3.29%                              |
| Other receivables      | 864                            | 4.89%                              |
| <b>Total</b>           | <b>11,615</b>                  | <b>3.16%</b>                       |

Hedges of financial liabilities at December 31, 2005, overall, result in a reduction in the nominal interest rate and, therefore, a reduction in the effective interest rate.

With regard to financial assets, the weighted average effective interest rate is not significantly affected by derivative instruments.

With reference to the concept of market risk, in the broad sense, the Group uses interest coupon step-ups and step-downs for certain bonds when there are changes in the rating. Such mechanisms, however, do not affect interest rate exposure, as previously described above, or the determination of the current effective interest rate. Additional information is provided in the Note 18 Financial liabilities current and non-current .

As to market risks connected with derivative financial instruments, reference should be made to Note 23 Financial instruments .

***Credit risk***

The management of the liquidity of the Group is guided by prudent criteria and is principally based on money market management and bond portfolio management. Temporary excess cash in the amount necessary to meet cash requirements within the next 12 months is invested in the money market. Excess liquidity which is expected to be required to meet cash requirements in beyond 12 months is invested in bonds.

In order to limit the risk of non-fulfillment of the obligations undertaken by the counterparty, deposits are held with leading high-credit-quality banking and financial institutions with at least an A rating. Furthermore, deposits are usually made for periods of less than 90 days. Other temporary investments of liquidity in Euro Commercial Paper relate to issuers with AAA, AA and A ratings and offices in Europe. With regard to bond portfolio management, the issuers have at least an A rating.

With a view towards minimizing credit risk, the Group practices a diversification policy for its investments in liquidity. Accordingly, there are no significant positions with any one single counterparty.

***Liquidity risk***

The Group's objective is to achieve an adequate level of financial flexibility by maintaining a margin of current treasury resources to cover refinancing requirements for at least the next 12 months using irrevocable bank lines and liquidity.

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Current financial assets at December 31, 2005 represent 114.2% of short term financial commitments (due in 2006) allowing a further and partial coverage of the amount due in 2007. 18.9% of gross financial indebtedness at December 31, 2005 will be due in the following 12 months.

***Fair value***

In order to determine the fair value of derivative instruments, the Telecom Italia Group uses various valuation models. The fair value of IRSs and CCIRSs reflects the difference between the fixed rate which should be paid/received and the interest rate (having the same maturity as the swap) based on market information at the measurement date. With regards to IRSs, the notional amount does not represent the amount exchanged between the parties and therefore does not constitute a measurement of credit risk exposure which, instead, is limited to the amount of the differential between the interest rates paid/received.

The fair value of CCIRSs, also depends on the differential between the exchange rate at the date of signing the contract and the exchange rate at the date of measurement, since CCIRSs imply the exchange of the principal, in the respective currencies of denomination, in addition to the exchange of flows of interest at the maturity date and at the intermediate payment dates.

With regard to the fair value of financial liabilities, reference should be made to the Note 23 Financial instruments for the assumptions and the amounts.

**NOTE 6 GOODWILL AND OTHER INTANGIBLE ASSETS WITH AN INDEFINITE LIFE**

Goodwill and other intangible assets with an indefinite life increased from 27,459 million as of December 31, 2004 to 43,980 million as of December 31, 2005.

The breakdown of goodwill by business segment and the changes during 2004 and 2005 are presented in the following tables:

|          | As of<br>January 1,<br>2004 | Discontinued<br>operations/<br>assets held<br>for sale |  | Increases          | Decreases | Exchange<br>differences | As of<br>December 31,<br>2004 |
|----------|-----------------------------|--|--|--------------------|-----------|-------------------------|-------------------------------|
|          |                             |  |  |                    |           |                         |                               |
|          |                             |  |  |                    |           |                         |                               |
|          |                             |  |  | (millions of Euro) |           |                         |                               |
| Wireline | 15,079                      |  |  | 326                | (292)     |                         | 15,113                        |

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|                     |               |              |            |              |            |               |
|---------------------|---------------|--------------|------------|--------------|------------|---------------|
| Mobile              | 11,603        | (122)        | 295        | (7)          |            | 11,769        |
| Media               | 210           |              |            | (11)         |            | 199           |
| Olivetti            | 6             |              |            |              |            | 6             |
| Other activities(*) | 574           | (24)         |            | (177)        | (1)        | 372           |
| <b>Total</b>        | <b>27,472</b> | <b>(146)</b> | <b>621</b> | <b>(487)</b> | <b>(1)</b> | <b>27,459</b> |

**Discontinued**

|                     | <b>As of</b>        | <b>operations/</b> |                           |                  | <b>Exchange</b>    | <b>As of</b>        |
|---------------------|---------------------|--------------------|---------------------------|------------------|--------------------|---------------------|
|                     | <b>December 31,</b> | <b>assets held</b> |                           |                  | <b>differences</b> | <b>December 31,</b> |
|                     | <b>2004</b>         | <b>for sale</b>    | <b>Increases</b>          | <b>Decreases</b> |                    | <b>2005</b>         |
|                     |                     |                    | <b>(millions of Euro)</b> |                  |                    |                     |
| Wireline            | 15,113              |                    | 254                       | (3)              |                    | 15,364              |
| Mobile              | 11,769              | (273)              | 16,716                    | (25)             | 199                | 28,386              |
| Media               | 199                 | (20)               | 58                        | (7)              |                    | 230                 |
| Olivetti            | 6                   |                    |                           | (6)              |                    |                     |
| Other activities(*) | 372                 | (372)              |                           |                  |                    |                     |
| <b>Total</b>        | <b>27,459</b>       | <b>(665)</b>       | <b>17,028</b>             | <b>(41)</b>      | <b>199</b>         | <b>43,980</b>       |

(\*) Other activities include the Finsiel group and the Entel Chile group which were sold during 2005.

The increase of 16,521 million in 2005 is due to the following transactions:

Increase:

- 11,804 million for the purchase of TIM ordinary and savings shares through the cash tender offer and on the market;

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- 4,850 million for the share exchange of TIM ordinary and savings shares following the merger with Telecom Italia;
- 249 million for the purchase of 100% of Liberty Surf Group S.A.;
- 199 million for exchange differences on the goodwill relating to the Brazilian companies;
- 62 million (exchange rate effect included) for the purchase of the shares of the minority shareholders of TIM Sul S.A. and TIM Nordeste Telecomunicações S.A. through a share capital increase by TIM Participações S.A., and as a result of the purchase of TIM Participações S.A. ordinary shares on the market by the parent, TIM Brasil;
- 41 million for the purchase of the business segments Elefante TV and Delta TV; and
- 22 million for other transactions.

## Decrease:

- 665 million relating to discontinued operations/assets held for sale, of which 273 million refers to TIM Hellas, 20 million to the Gruppo Buffetti and 372 million to the Entel Chile group;
- 25 million for the dilution in TIM Participações S.A. following the capital increase reserved for the minority shareholders;
- 10 million for the sale of Televoice S.p.A. and Databank S.p.A. and other minor companies; and
- 6 million for the impairment of the goodwill relating to the Cash Generating Unit (CGU) Olivetti.

The gross carrying amounts of goodwill and the relative impairment losses accumulated from January 1, 2004 (date of allocation to the cash-generating units) to December 31, 2005, are summarized as follows:

|          | <b>As of December 31, 2005</b>       |  |                                    |
|----------|--------------------------------------|--|------------------------------------|
|          | <b>Gross<br/>carrying<br/>amount</b> | <b>Accumulated<br/>impairment<br/>losses</b> | <b>Net<br/>carrying<br/>amount</b> |
|          | (millions of Euro)                   |  |                                    |
| Wireline | (*)15,656                            | (*)292                                       | 15,364                             |
| Mobile   | 28,393                               | (7)  | 28,386                             |



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|              |               |              |               |
|--------------|---------------|--------------|---------------|
| Media        | 230           |              | 230           |
| Olivetti     | 6             | (6)          |               |
| <b>Total</b> | <b>44,285</b> | <b>(305)</b> | <b>43,980</b> |

(\*) Includes 282 million relating to the settlement with De Agostini in 2004.

Goodwill under IAS 36 is not amortized but is subject to an impairment test at least annually. To test for impairment, goodwill must be allocated to cash-generating units or groups of cash-generating units which must not be larger than a business segment determined in accordance with IAS 14. The criteria followed for the allocation of goodwill considers the lowest level at which goodwill is monitored for internal management purposes.

The business units (or groups of units) to which goodwill was allocated are as follows:

| <u>Sector</u> | <u>Group of units</u>                                |
|---------------|--|
| Wireline      | Liberty Surf Group                                   |
|               | Hansenet   |
|               | Wireline (excluding Liberty Surf Group and Hansenet) |
| Mobile        | Domestic   |
|               | Brazil   |
| Media         | TI Media   |

The value used to determine the recoverable amount of the groups of units to which the goodwill was allocated is the value in use, with the exception of TI Media, which is a listed company, and therefore market capitalization at

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December 31, 2005 was used as the measure of the entity's fair value. For AVEA I.H.A.S., the amount of U.S.\$500 million was used; being the amount at which the equity investment could be sold under the agreements reached with Saudi Oger.

The most representative basic assumptions for the calculation of the value in use of each group of cash generating units are presented in the following table (Ebitda means Earnings before interest, taxes, depreciation and amortization):

| <b>Liberty Surf Group</b>                                   | <b>Hansenet</b>                          | <b>Wireline</b>   | <b>Mobile Domestic</b>  | <b>Mobile Brazil</b>  |
|---|--|---|---|---|
| Number of customers   | Number of customers                      | Ebitda margin (Ebitda/sales) during the period of the plan  | Ebitda margin (Ebitda/sales) during the period of the plan  | Growth rate of sales during the forecast period (2005-2008) |
| Margin per customer during the period of the plan 2005-2012 | Gross operating margin expected for 2006 | Investments to maintain profit capability (in proportion to sales)  | Investments to maintain profit capabilities (in proportion to sales)  | Ebitda margin (Ebitda/sales) during the period of the plan  |
|   |  | Non-recurring expenses excluded from expected Ebitda for extrapolation in the calculation of the end amount | Non-recurring expenses excluded from expected Ebitda for extrapolation in the calculation of the end amount | Exchange rate Real/Euro                                     |
| Cost of capital   | Cost of capital                          | Cost of capital   | Cost of capital   | Cost of capital   |
| Long-term growth rate                                       | Long-term growth rate                    | Long-term growth rate   | Long-term growth rate   | Long-term growth rate                                       |

All the plan figures are based on the Group's most recent experience and the best estimates of management for the period of the plan 2005-2008. In the case of Liberty Surf, the impairment test required an extension of the plan to 2012, in that the network investments needed to develop broadband in France have a long-term time frame and the aggregation of the entity acquired from Tiscali (the previous Liberty Surf Group) with the pre-existing TI France was effected only in November 2005. The new Liberty Surf Group will begin a significant capital expenditure plan for network development in 2006 which was not considered for purposes of the net present value used in the impairment test, but by assuming an appropriate proportion of results of the merged businesses to comply with IAS 36, paragraph 44. With regard to Hansenet, on the other hand, in order to eliminate the net present value of future investments in the impairment test, only the flow of the expected results for 2006 was used, forecasting it in perpetuity.

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The nominal growth rates used to estimate the end amount are the following (the growth rate of Brazil refers to flows in Brazilian reais):

| <u>Liberty Surf Group</u> | <u>Hansenet</u> | <u>Wireline</u> | <u>Mobile Domestic</u> | <u>Mobile Brazil</u> |
|---------------------------|-----------------|-----------------|------------------------|----------------------|
| +0.5%                     | +0.5%           | -1%             | +0.5%                  | +6.2%                |

Such rates fall within the range of growth rates applied by analysts following Telecom Italia stock (as can be seen from the reports published after November 8, 2005: the date the third-quarter 2005 results were announced).

The cost of capital was estimated using three external sources:

- a) the February 4, 2006 resolution by the Italian National Regulatory Agency for Communications which provides the model for determining the cost of capital for fixed telephone operators in Annex 1. The

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criteria for the estimate of the cost of capital proposed by the authority is CAPM Capital Asset Pricing Model (the same criteria used by the Group to estimate the value in use and referred to in the Annex A to IAS 36);

- b) the weighted average cost of capital (wacc) used by the analysts following Telecom Italia stock in the reports published between November 8, 2005 and January 2006, relative to the principal business segments of the group. Since there is a direct correlation between the cost of capital used by the analysts and the long-term growth rate (g) forecast for the purpose of estimating the end amount, the comparison was also made on the capitalization rates (wacc-g);
- c) the Beta coefficient for business segments arrived at by using the Beta coefficients of the 12 European multibusiness incumbents (wireline, mobile and other), including Telecom Italia itself, adjusted to take into account the target financial structure of the Group.

On the basis of these elements, the weighted average cost of capital and the Beta coefficients were estimated for each segment/business unit as follows:

|                     | <b>Liberty Surf<br/>Group</b> | <b>Hansenet</b> | <b>Wireline<br/>(excluded<br/>Liberty Surf<br/>Group and<br/>Hansenet)</b> | <b>Mobile Domestic</b> | <b>Mobile Brazil</b> |
|---------------------|-------------------------------|-----------------|--|------------------------|----------------------|
| Wacc after taxes    | 7.22%                         | 7.22%           | 6.00%  | 6.30%                  | 14.4%                |
| Wacc after taxes -g | 6.72%                         | 6.72%           | 7.00%  | 6.80%                  | 8.2%                 |

Having considered the nominal flows of the result for the estimate of the value in use, the discount rates are also expressed in nominal terms (in reais for Brazil).

A sensitivity analysis of the results was carried out for all segments which showed that in all cases, with the exception of Liberty Surf Group, the values in use remain significantly higher than the carrying amounts. A change of an increase of 50 basis points (hundredths of percentage points) would generate an impairment of the Liberty Surf Group business unit of 42 million. However, reference to multiples of comparable companies leads to amounts significantly higher than those recorded in the financial statements.

The second level of impairment testing was effected by considering the values in use of the groups of units/segments to which goodwill was allocated, the value in use of Olivetti, the surplus assets excluded from the configuration of accounting capital to be compared with the operational value in use of the individual segments and the Corporate segment. For the latter, a negative amount was estimated. The capitalization rate of the net expenses of the Corporate structure was prudently made to coincide with the risk-free rate. At this second level, too, there is no impairment.

**NOTE 7 INTANGIBLE ASSETS WITH A FINITE LIFE**

**Intangible assets with a finite life** increased from 6,774 million at December 31, 2004 to 6,810 million. A breakdown of the composition and movements during the year are presented in the following tables:

|  | As of<br>January 1,<br>2004 | Discontinued<br>operations/<br>assets held<br>for sale | Additions    | Amortization   | Impairment<br>losses/<br>Reversals | Disposals   | Exchange<br>differences | Other<br>changes | As of<br>December 31,<br>2004 |
|--|-----------------------------|--|--------------|----------------|------------------------------------|-------------|-------------------------|------------------|-------------------------------|
| (millions of Euro)                                   |                             |  |              |                |                                    |             |                         |                  |                               |
| Industrial patents and intellectual property rights  | 1,987                       | (50)   | 1,149        | (1,168)        | (9)                                | (2)         | 1                       | 602              | 2,510                         |
| Concessions, licenses, trademarks and similar rights | 3,758                       | (1)  | 18           | (254)          | (59)                               |             | (1)                     | 43               | 3,504                         |
| Other intangible assets                              | 67                          | (25)   | 38           | (21)           | (3)                                | (4)         |                         |                  | 52                            |
| Work in progress and advances to suppliers           | 673                         | (6)  | 730          |                | (2)                                | (10)        |                         | (677)            | 708                           |
| <b>Total</b>   | <b>6,485</b>                | <b>(82)</b>  | <b>1,935</b> | <b>(1,443)</b> | <b>(73)</b>                        | <b>(16)</b> |                         | <b>(32)</b>      | <b>6,774</b>                  |

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|  | As of<br>December 31,<br>2004 | Discontinued<br>operations/<br>assets held<br>for sale | Additions    | Amortization   | Impairment<br>losses/<br>Reversals         | Disposals   | Exchange<br>differences | Other<br>changes | As of<br>December 31,<br>2005 |
| (millions of Euro)   |                               |  |              |                |  |             |                         |                  |                               |
| Industrial<br>patents and<br>intellectual<br>property rights     | 2,510                         | (99)   | 1,276        | (1,414)        | (10)                                       | (20)        | 91                      | 476              | 2,810                         |
| Concessions,<br>licenses,<br>trademarks<br>and similar<br>rights | 3,504                         | (365)  | 51           | (253)          |  | (6)         | 188                     | 199              | 3,318                         |
| Other<br>intangible<br>assets                                    | 52                            | (16)   | 47           | (17)           |  |             |                         | (9)              | 57                            |
| Work in<br>progress and<br>advances to<br>suppliers              | 708                           | (14)   | 411          |                |  |             | 18                      | (498)            | 625                           |
| <b>Total</b>   | <b>6,774</b>                  | <b>(494)</b>   | <b>1,785</b> | <b>(1,684)</b> | <b>(10)</b>                                | <b>(26)</b> | <b>297</b>              | <b>168</b>       | <b>6,810</b>                  |

Additions made in 2005 include 182 million of capitalized internal construction costs.

**Industrial patents and intellectual property rights** at December 31, 2005 consist almost entirely of applications software purchased outright and user license rights acquired for an indefinite time period (and are amortized over the useful life estimated in 3 years). These relate mainly to the Wireline Business Unit for 1,473 million and the Mobile Business Unit for 1,233 million.

**Concessions, licenses, trademarks and similar rights** mainly refer to the Mobile Business Unit ( 2,869 million) for the remaining unamortized cost of UMTS and PCS licenses, to the Wireline Business Unit ( 287 million, of which 169 million refers to costs principally for Indefeasible Rights of Use IRU) and to the Media Business Unit ( 158 million for the costs of purchasing TV frequencies, of which 126 million was acquired through the purchase of the Elefante TV and Delta TV).

The remaining unamortized mobile telephone licenses totalling 2,869 million refer to the following:

- Licenses of Tim Italia:

UMTS for 2,148 million expiring in 2021 (amortized in 18 years);

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Wireless Local Loop for 12 million expiring in 2016 (amortized in 15 years).

- Licenses of the Brazilian companies:

GSM of TIM Celular for a total of 539 million expiring between 2016 and 2018 (amortized in 13-15 years);

TDMA and GSM of Maxitel for a total of 162 million expiring between 2012 and 2013 (amortized in 9-13 years);

GSM of TIM Participações for a total of 8 million expiring between 2007 and 2009.

Radio and television frequencies acquired through the purchase of the business segments Elefante TV and Delta TV are recorded, at December 31, 2005, for 124 million, net of the amortization charge for the year of 2 million, and will be used for digital technology and have an estimated useful life up to 2018.

**Other intangible assets** include 13 million related to the value allocated to the Customer List on the purchase of the controlling interest in Liberty Surf Group S.A..

In 2005, impairment losses of 10 million, net of impairment reversals of 1 million, mainly refer to Maxitel. In 2004, net impairment losses were 73 million and mainly referred to the reorganization of the Latin American Nautilus group.

Amortization and impairment losses are recorded in the statement of operations as components of the operating income.

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The gross carrying amount, accumulated impairment losses and accumulated amortization at December 31, 2005 can be summarized as follows:

|  | Gross<br>carrying<br>amount | Accumulate<br>impairment<br>losses | Accumulated<br>amortization | Net<br>carrying<br>amount |
|--|-----------------------------|------------------------------------|-----------------------------|---------------------------|
|  |                             |                                    |                             |                           |
|  |                             | (millions of Euro)                 |                             |                           |
| Industrial patents and intellectual property rights  | 9,886                       | (15)                               | (7,061)                     | 2,810                     |
| Concessions, licenses, trademarks and similar rights | 4,457                       | (276)                              | (863)                       | 3,318                     |
| Other intangible assets                              | 170                         | (80)                               | (33)                        | 57                        |
| Work in progress and advances to suppliers           | 625                         |                                    |                             | 625                       |
| <b>Total</b>   | <b>15,138</b>               | <b>(371)</b>                       | <b>(7,957)</b>              | <b>6,810</b>              |

The impairment losses in Concessions, licenses, trademarks and similar rights mainly refer to the Indefeasible Rights of Use (IRU) of the capacity and cables relating to the international connections acquired by LAN.

Such impairments, principally relating to the years prior to 2004, are the result of the altered and shrunken market value of international broadband compared to the expectations anticipated at the historical date of those investments. This is due to the significant reduction in expectations of the growth of the new economy over the past years, in addition to the persistent negative economic situation in the region in which the subsidiary operates (Latin America and, in particular, Argentina).

**NOTE 8 TANGIBLE ASSETS (OWNED AND UNDER FINANCE LEASES)**
***Property, plant and equipment owned***

Property, plant and equipment owned decreased from 17,853 million as of December 31, 2004 to 16,443 million. Details are as follows:

| As of<br>January 1,<br>2004 | Discontinued<br>operations/<br>assets held<br>for sale | Additions | Depreciation | Impairment<br>losses/<br>reversals | Disposals | Exchange<br>Differences | Other<br>changes | As of<br>December 31,<br>2004 |
|-----------------------------|--|-----------|--------------|------------------------------------|-----------|-------------------------|------------------|-------------------------------|
|                             |  |           |              |                                    |           |                         |                  |                               |



|  | (millions of Euro) |              |              |                |             |             |             |           |               |
|--|--------------------|--------------|--------------|----------------|-------------|-------------|-------------|-----------|---------------|
| Land   | 242                | (10)         |              |                |             | (2)         | (1)         | (5)       | 224           |
| Civil and industrial buildings                     | 1,428              | (22)         | 97           | (116)          | (23)        | (23)        | (4)         | 121       | 1,458         |
| Plant and equipment                                | 14,237             | (104)        | 2,054        | (3,049)        | (56)        | (22)        | (42)        | 1,132     | 14,150        |
| Manufacturing and distribution equipment           | 46                 |              | 34           | (28)           |             | (5)         |             | 15        | 62            |
| Aircrafts and ships                                | 78                 |              |              | (12)           | (11)        |             |             |           | 55            |
| Other  | 756                | (21)         | 293          | (346)          | (2)         | (14)        |             | 296       | 962           |
| Construction in progress and advances to suppliers | 1,615              | (11)         | 868          |                | 9           | (6)         |             | (1,533)   | 942           |
| <b>Total</b>                                       | <b>18,402</b>      | <b>(168)</b> | <b>3,346</b> | <b>(3,551)</b> | <b>(83)</b> | <b>(72)</b> | <b>(47)</b> | <b>26</b> | <b>17,853</b> |

**Discontinued**

|  | As of<br>December 31,<br>2004 | operations/<br>assets held<br>for sale | Additions    | Depreciation   | Impairment<br>losses/<br>reversals | Disposals    | Exchange<br>Differences | Other<br>changes | As of<br>December 31,<br>2005 |
|--|-------------------------------|--|--------------|----------------|------------------------------------|--------------|-------------------------|------------------|-------------------------------|
|  | (millions of Euro)            |  |              |                |                                    |              |                         |                  |                               |
| Land   | 224                           | (14)                                   |              |                |                                    | (62)         | 2                       | 5                | 155                           |
| Civil and industrial buildings                     | 1,458                         | (181)                                  | 23           | (103)          | (1)                                | (249)        | 19                      | 6                | 972                           |
| Plant and equipment                                | 14,150                        | (1,219)                                | 2,069        | (2,910)        |                                    | (29)         | 378                     | 468              | 12,907                        |
| Manufacturing and distribution equipment           | 62                            | (5)                                    | 38           | (31)           |                                    |              |                         | 8                | 72                            |
| Aircrafts and ships                                | 55                            |  |              | (9)            |                                    |              |                         |                  | 46                            |
| Other  | 962                           | (86)                                   | 380          | (363)          |                                    | (6)          | 99                      | 188              | 1,174                         |
| Construction in progress and advances to suppliers | 942                           | (77)                                   | 790          |                | (8)                                | (2)          | 59                      | (587)            | 1,117                         |
| <b>Total</b>                                       | <b>17,853</b>                 | <b>(1,582)</b>                         | <b>3,300</b> | <b>(3,416)</b> | <b>(9)</b>                         | <b>(348)</b> | <b>557</b>              | <b>88</b>        | <b>16,443</b>                 |

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Additions in 2005 include 155 million of capitalized internal construction costs.

During 2005, the impairment losses of 9 million refer mainly to the write-down of telephone equipment which is being replaced by technologically advanced equipment. In 2004, the impairment losses totaled 83 million and resulted mainly from the reorganization of the Latin American Nautilus group.

Depreciation and impairment losses are recorded in the statement of operations within the operating income.

Disposals in 2005 include 304 million for 561 buildings contributed to Fondo Raissa and 246 buildings contributed to Fondo Spazio Industriale which are part of the agreement to dispose of more than 1,300 buildings for a total of approximately 1 billion.

These real estate transactions fall under the scope of the network restructuring process resulting from the changes in technology in the field of telecommunications which make it possible to reorganize and optimize the physical spaces occupied by the telephone exchanges and, as a result, gradually free up the relative properties.

In 2005, the transactions generated a gain on consolidation of 264 million, net of incidental charges, and reduced the consolidated net financial debt by 568 million. This is after taking into account the recognition, in accordance with the finance method under IAS 17, of 78 buildings sold to Fondo Raissa and subsequently leased back under long-term finance leases. These buildings have therefore been reclassified from owned properties to leased properties.

The second stage of the project will be completed during the first half of 2006 when more than 500 buildings will be contributed to Fondo Raissa and Fondo Spazio Industriale for a total of approximately 431 million.

The gross carrying amount, accumulated impairment losses and accumulated depreciation at December 31, 2005 can be summarized as follows:

|                                | As of December 31, 2005     |                                     |                             |                      |
|--------------------------------|-----------------------------|-------------------------------------|-----------------------------|----------------------|
|                                | Gross<br>carrying<br>amount | Accumulated<br>impairment<br>losses | Accumulated<br>depreciation | Net<br>book<br>value |
|                                | (millions of Euro)          |                                     |                             |                      |
| Land                           | 155                         |                                     |                             | 155                  |
| Civil and industrial buildings | 2,247                       | (35)                                | (1,240)                     | 972                  |
| Plant and equipment            | 58,143                      | (151)                               | (45,085)                    | 12,907               |

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|   |               |              |                 |               |
|---|---------------|--------------|-----------------|---------------|
| Manufacturing and distribution equipment          | 756           | (5)          | (679)           | 72            |
| Aircrafts and ships                               | 145           | (11)         | (88)            | 46            |
| Other   | 4,159         | (7)          | (2,978)         | 1,174         |
| Construction in progress and advances to supplier | 1,126         | (9)          |                 | 1,117         |
| <b>Total</b>                                      | <b>66,731</b> | <b>(218)</b> | <b>(50,070)</b> | <b>16,443</b> |

**Assets held under finance leases**

Assets held under finance leases decreased from 1,653 million at December 31, 2004 to 1,598 million at December 31, 2005. Details of the composition and changes are as follows:

|                                   | Discontinued                |  |           |              |            | Exchange<br>Differences | Other<br>changes | As of<br>December 31,<br>2004 |
|-----------------------------------|-----------------------------|--|-----------|--------------|------------|-------------------------|------------------|-------------------------------|
|                                   | As of<br>January 1,<br>2004 | Operations/<br>assets held<br>for sale | Additions | Depreciation | Disposals  |                         |                  |                               |
| (millions of Euro)                |                             |  |           |              |            |                         |                  |                               |
| Land                              | 8                           |  |           |              |            |                         |                  | 8                             |
| Civil and industrial<br>buildings | 1,638                       |  | 4         | (93)         |            |                         | 12               | 1,561                         |
| Plant and equipment               | 2                           | (1)                                    |           |              |            |                         |                  | 1                             |
| Aircrafts and ships               | 22                          |  |           | (4)          |            |                         |                  | 18                            |
| Other                             | 77                          |  | 39        | (43)         | (2)        |                         | (6)              | 65                            |
| <b>Total</b>                      | <b>1,747</b>                | <b>(1)</b>                             | <b>43</b> | <b>(140)</b> | <b>(2)</b> |                         | <b>6</b>         | <b>1,653</b>                  |

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|---|--|-------------|--------------|--|-------------------------|------------------|-------------------------------|
| As of<br>December 31,<br>2004                           | Discontinued<br>Operations/<br>assets held<br>for sale | Additions   | Depreciation | Disposals                                  | Exchange<br>Differences | Other<br>changes | As of<br>December 31,<br>2005 |
|   |  |             |              |  |                         |                  |                               |
| (millions of Euro)                                      |  |             |              |  |                         |                  |                               |
| Land  | 8  | (3)         |              |  |                         | (5)              |                               |
| Civil and industrial<br>buildings                       | 1,561  | (21)        | 14           | (93)                                       |                         | 16               | 1,477                         |
| Plant and equipment                                     | 1  | (1)         |              | (1)  |                         | 2                | 1                             |
| Aircrafts and ships                                     | 18   |             |              | (4)  |                         |                  | 14                            |
| Other   | 65   | (2)         | 46           | (34)                                       | (4)                     |                  | 71                            |
| Construction in<br>progress and<br>advances to supplier |  |             | 28           |  |                         | 7                | 35                            |
| <b>Total</b>  | <b>1,653</b>   | <b>(27)</b> | <b>88</b>    | <b>(132)</b>                               | <b>(4)</b>              | <b>20</b>        | <b>1,598</b>                  |

Depreciation and impairment losses are recorded in the statement of operations within the operating income.

Other changes in 2005 include 50 million representing the net carrying amount of 78 owned buildings contributed to Fondo Raissa and the long-term financial leaseback of these buildings which, in accordance with IAS 17, have been reclassified from owned properties to leased properties, and 2 million as a result of the acquisition of the Liberty Surf group.

The gross carrying amount, accumulated impairment losses and accumulated depreciation at December 31, 2005 can be summarized as follows:

|   | As of December 31, 2005     |                                     |                             |                      |
|---|-----------------------------|-------------------------------------|-----------------------------|----------------------|
|   | Gross<br>carrying<br>amount | Accumulated<br>impairment<br>losses | Accumulated<br>depreciation | Net<br>book<br>value |
| (millions of Euro)                                |                             |                                     |                             |                      |
| Civil and industrial buildings                    | 1,967                       | (27)                                | (463)                       | 1,477                |
| Plant and equipment                               | 22                          |                                     | (21)                        | 1                    |
| Aircrafts and ships                               | 30                          |                                     | (16)                        | 14                   |
| Other   | 152                         |                                     | (81)                        | 71                   |
| Construction in progress and advances to supplier | 35                          |                                     |                             | 35                   |
| <b>Total</b>                                      | <b>2,206</b>                | <b>(27)</b>                         | <b>(581)</b>                | <b>1,598</b>         |

As of December 31, 2005, minimum lease payments due in future years and their present value are as follows:

|                   | Minimum lease<br>payments | Present value of<br>minimum lease<br>payments |
|-------------------|---------------------------|---|
|                   | (millions of Euro)        |   |
| Within 1 year     | 234                       | 218   |
| From 2 to 5 years | 868                       | 685   |
| Beyond            | 1,965                     | 891   |
|                   | <b>3,067</b>              | <b>1,794</b>                                  |

|  | As of December 31, |              |
|--|--------------------|--------------|
|  | 2004               | 2005         |
| Future lease payments  | 3,139              | 3,067        |
| Less: Interest portion   | (1,369)            | (1,273)      |
| <b>Present value of lease payments</b>   | <b>1,770</b>       | <b>1,794</b> |
| Finance lease obligations  | 2,087              | 2,128        |
| Finance lease obligations relating to Discontinued operations/assets held for sale | (34)               |              |
| Financial receivables for lessors net investments                                  | (283)              | (334)        |
| <b>Total net finance lease liabilities</b>   | <b>1,770</b>       | <b>1,794</b> |

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**Other non-current assets** increased from 2,338 million as of December 31, 2004 to 3,163 million as of December 31, 2005. Other non-current assets are detailed as follows:

|  | <b>As of December 31,</b> |              |
|--|---------------------------|--------------|
|  | <b>2004</b>               | <b>2005</b>  |
|  | <b>(millions of Euro)</b> |              |
| Equity investments in:                                       |                           |              |
| Associated companies accounted for using the equity method   | 585                       | 765          |
| Jointly controlled companies                                 |                           | 16           |
| Other companies  | 479                       | 561          |
|  | <b>(A)</b>                | <b>1,342</b> |
| Securities and financial receivables:                        |                           |              |
| Securities other than equity investments                     | 7                         | 8            |
| Financial receivables and other non-current financial assets | 386                       | 988          |
|  | <b>(B)</b>                | <b>996</b>   |
| Miscellaneous receivables and other non-current assets:      |                           |              |
| Miscellaneous receivables                                    | 381                       | 358          |
| Medium/long-term prepaid expenses                            | 500                       | 467          |
|  | <b>(C)</b>                | <b>825</b>   |
| <b>Total</b>   | <b>(D=A+B+C)</b>          | <b>3,163</b> |

**Major transactions involving equity investments****a) Acquisitions in 2004****Capital increases by ETECSA**

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During the first half of 2004, the Shareholders Meeting of the Cuban company voted three increases in share capital in order to fund the extraordinary financial requirements for the payment of the new license granted by the MIC (the Ministry of Cuban Telecommunications), with the following characteristics:

- on March 4, 2004, U.S.\$23.8 million through the issue of 165 new shares for a unit price of U.S.\$144,190;
- on May 20, 2004, U.S.\$31.6 million through the issue of 219 new shares for a unit price of U.S.\$144,190;
- on June 14, 2004, U.S.\$61.9 million through the issue of 429 new shares for a unit price of U.S.\$144,190.

Telecom Italia International N.V. subscribed to such increases based on its investment (27%) paying, respectively, U.S.\$6.3 million, U.S.\$8.5 million and U.S.\$16.7 million, and receiving in exchange, respectively, 44, 59, and 116 new shares.

Telecom Italia International N.V.'s interest has remained unchanged.

### **b) Divestitures in 2004**

#### **Sale of Euskaltel**

On January 16, 2004, Telecom Italia International N.V. signed a contract with Araba Gertu S.A. for the sale of a 3.1% stake in Euskaltel to Araba Gertu S.A. for a total price of 13.6 million. This sale was conditional upon the pre-emptive right procedure provided by Euskaltel's bylaws.

The closing took place on February 19, 2004. After the pre-emption right was exercised by Iberdrola S.A., an Euskaltel shareholder, the sale of the above stake occurred through the signing of two separate contracts under which Telecom Italia International N.V. sold 149,231 shares to Araba Gertu S.A. for consideration of 12.1 million and 18,719 shares to Iberdrola S.A. for consideration of 1.5 million.

The remaining stake of 3% was sold in October 2005.

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**Sale of Netco Redes S.A.**

On June 24, 2004, Telecom Italia International N.V. transferred 301,404 Netco Redes shares to Auna, receiving the entire agreed amount of consideration of 30 million, including interest accrued up to the closing date, on June 30, 2004. A net gain of 6 million was realized on consolidation.

**Sale of Pirelli & C. Real Estate S.p.A. shares**

During 2004, all the Pirelli & C. Real Estate S.p.A. shares held (812,086) were sold for total cash proceeds of 24 million.

**Sale of SKY Italia S.r.l.**

On September 28, 2004, Telecom Italia sold its 19.9% interest in Sky Italia S.r.l. to the NewsCorp group. The consideration on the transaction was 88 million. The transaction gave rise to a gain against the carrying value at June 30, 2004 of 31.4 million. Such gain offset the effects of the impairment losses recognized during the first half of the year so that the transaction had almost no economic impact on the consolidated financial statements.

**Sale of Mirror International Holding S.a.r.l.**

On December 21, 2004, Mirror International Holding S.a.r.l. purchased, through a buyback, 30% of its capital held by Telecom Italia. Consideration for the transaction was 75 million, 73 million for the sale and 2 million for the loan repayment. The deal gave rise to a gain on consolidation of 24 million for the sale of the above interest and 61 million for the release of the remaining part of the gain on the sale, in 2001, of 70% of Mirror International Holding, the company to which the investments in the satellite consortiums had previously been transferred.

**c) Acquisitions in 2005**

**Privatization of Turk Telekom**

On July 1, 2005, the bidding ended for the privatization of the majority stake (55%) of the Turkish telecommunications operator Turk Telekom. The bid was won for U.S.\$6,550 million by Oger Telecom, a newly-formed company controlled by the Saudi-Lebanese group Saudi Oger Limited and in which Telecom Italia through TIM International made an initial investment of



U.S.\$200 million (13.33%). The partnership between Telecom Italia and Saudi Oger Limited covers mobile telecommunications, while for land-line telecommunications Oger Telecom will continue its collaboration with BT Telconsult. After closing the deal, Telecom Italia and Oger Telecom will sign a four-year agreement for technical assistance with AVEA I.H.A.S., the Turkish mobile operator in which stakes are held by TIM International (40.5647%), Turk Telekom (40.5647%) and Is Bank (18.8706%). The agreements with Saudi Oger also provide that the investment in AVEA I.H.A.S., held by TIM International, may be transferred to Turk Telekom, and that the proceeds from the sale shall be partially reinvested in Oger Telecom shares, or alternatively the sale of the AVEA I.H.A.S. shares may be carried out by directly selling to Oger Telecom (in exchange of Oger Telecom shares). The valuation of AVEA I.H.A.S. shares held by TIM International were initially agreed in a range of between U.S.\$400 million and U.S.\$600 million and then finally established at U.S.\$500 million. Oger Telecom is expected to be listed on the Dubai stock exchange within the next three years with the possibility of TIM International investing proportionally in the initial placement. Should the listing not take place within the agreed timeframe, TIM International may exercise a put option to sell Saudi Oger Limited the Oger Telecom shares resulting from the sale of the current investment in AVEA I.H.A.S., which represented one-fourth of the Oger Telecom shares initially subscribed by TIM International. If the put option is not exercised, the counterpart may exercise a call option on the same shares.

#### **Acquisition of Luna Rossa Challenge 2007 S.L. and Luna Rossa Trademark**

On July 27, 2005, Telecom Italia purchased 49% of the share capital of Luna Rossa Challenge 2007 S.L., a Spanish-registered company, by subscribing to a share capital increase reserved for Telecom Italia of approximately 2 million.

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On July 28, 2005, Telecom Italia purchased 49% of the share capital of Luna Rossa Trademark S.a.r.l., a Luxembourg-registered company, from Prada S.A. for 10 million.

**d) Divestitures of equity investments****Sale of CMobil CZ**

Under the process of rationalization of its international investment portfolio, on March 24, 2005, TIM finalized the sale of 7.16% of the share capital of CMobil CZ (a Dutch holding company which holds a 60.8% stake in T-Mobile CZ) with T-Mobile Global Holding. This investment corresponds to an indirect interest of 4.35% in T-Mobile CZ, one of the largest mobile operators in the Czech Republic. The sales price was 70.5 million and resulted in a gain of approximately 61 million.

**Equity investments in associates accounted for using the equity method** are detailed as follows:

|                                     | As of<br>January 1,<br>2004   | Discontinued<br>operations/<br>assets held<br>for sale | Investments | Disposals and<br>capital<br>reimbursements | Equity<br>method<br>adjustments | Reclassifications<br>and other<br>changes | As of<br>December 31,<br>2004 |
|-------------------------------------|-------------------------------|--|-------------|--|---------------------------------|---|-------------------------------|
| (millions of Euro)                  |                               |  |             |  |                                 |   |                               |
| ETECSA.                             | 392                           |  | 26          |  | (128)                           |   | 290                           |
| Italtel Holding                     | 35                            |  |             |  | (3)                             |   | 32                            |
| Mirror<br>International<br>Holdings | 48                            |  |             | (48)                                       |                                 |   |                               |
| Netco Redes                         | 24                            |  |             | (24)                                       |                                 |   |                               |
| Siemens<br>Informatica              | 16                            |  |             |  | (2)                             |   | 14                            |
| Sky                                 | 44                            |  | 55          | (99)                                       |                                 |   |                               |
| Tiglio I                            | 234                           |  |             | (76)                                       | (5)                             |   | 153                           |
| Tiglio II                           | 78                            |  |             | (25)                                       | 7                               |   | 60                            |
| Other                               | 42                            | (8)  | 2           | (3)  | 3                               |   | 36                            |
| <b>Total</b>                        | <b>913</b>                    | <b>(8)</b>   | <b>83</b>   | <b>(275)</b>                               | <b>(128)</b>                    |   | <b>585</b>                    |
|                                     | As of<br>December 31,<br>2004 | Discontinued<br>operations/<br>assets held<br>for sale | Investments | Disposals and<br>capital<br>reimbursements | Equity<br>method<br>adjustments | Reclassifications<br>and other<br>changes | As of<br>December 31,<br>2005 |

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(millions of Euro)

|                                 |            |            |             |           |            |
|---------------------------------|------------|------------|-------------|-----------|------------|
| AVEA I.H.A.S.                   | 122        |            | (122)       |           |            |
| Brasil Telecom<br>Participações |            |            | (2)         | 23        | 21         |
| ETECSA.                         | 290        |            | 39          |           | 329        |
| Italtel Holding                 | 32         |            | 6           |           | 38         |
| Siemens<br>Informatica          | 14         |            | (10)        |           | 4          |
| Solpart<br>Participações        |            |            | (17)        | 142       | 89         |
| Tiglio I                        | 153        |            | (41)        | (17)      | 95         |
| Tiglio II                       | 60         |            | (33)        | (10)      | 17         |
| Other                           | 36         | 14         | (7)         | 4         | 47         |
| <b>Total</b>                    | <b>585</b> | <b>136</b> | <b>(98)</b> | <b>30</b> | <b>112</b> |
|                                 |            |            |             |           | <b>765</b> |

The Equity method adjustments includes the share of earnings for the year and the translation adjustments of the foreign companies financial statements. In particular, the impact on the 2005 consolidated statement of operations relates to AVEA I.H.A.S. (a decrease of 122 million), ETECSA (an increase of 45 million), Solpart Participações (an increase of 94 million) and other companies (a decrease of 10 million).

At December 31, 2004, the carrying value of the equity investment in AVEA I.H.A.S. was zero because the contribution of the IS TIM investment to AVEA I.H.A.S. took place at the pre-existing carrying value of the investment which in prior years had been written off. During 2004, the losses incurred by AVEA I.H.A.S. were not recognized because the carrying value of the investment in AVEA I.H.A.S. had been written off.

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During 2005, the share of the losses of the AVEA I.H.A.S. amounted to 152 million and 122 million of that amount was recorded in the statement of operations up to the carrying amount of the associate which had increased as a result of a share capital increase.

The equity investments in Solpart Participações and in Brasil Telecom Participações have been valued using the equity method following the signing of agreements during the first half of 2005 which reinstated Telecom Italia's governance rights in Solpart. Such rights had been temporarily suspended in August 2002.

The value of the equity investment in ETECSA includes 64 million for the unamortized portion of goodwill, namely the excess of the book value over the corresponding share of the underlying net assets acquired.

The investment in Italtel Holding S.p.A. is included in equity investments in associates accounted for using the equity method because, although owning a 19.37% stake (below 20% of voting rights exercisable), Telecom Italia is able to exercise a significant influence through the rights attributed to it by the shareholders' agreements.

The Italtel Holding S.p.A. shareholders' meeting held on February 27, 2006 approved the filing of a request to list its ordinary shares on the Italian stock exchange.

Aggregate 2005 financial information of the major associates prepared in accordance with IFRS, based on Telecom Italia Group's share, is as follows:

|                   | <b>As of<br/>December 31,<br/>2005</b> |
|-------------------|--|
|                   | <b>(millions of Euro)</b>              |
| Total assets      | 4,961                                  |
| Total liabilities | 2,606                                  |
| Revenues          | 2,278                                  |
| Loss for the year | (114)                                  |

**Equity investments in jointly-controlled companies** include the investments in Perseo S.r.l. and Sofora Telecomunicaciones S.A., in which 50% stakes are held.

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The equity investment in Sofora Telecomunicaciones S.A. was accounted for using the equity method. Since 2001, following the monetary crisis in Argentina, the net equity of the company, which controls the Telecom Argentina group, was negative. Therefore, the carrying value, including the goodwill acquired, had been written off. In 2005, the net equity of the Sofora group became positive as a result of restructuring a part of the Telecom Argentina group's debt. As a result, the carrying value was adjusted for the share of ownership ( 16 million). However, all the reasons which led to the impairment of the investment in previous years have not been eliminated, therefore, the impairment has not been reversed.

Aggregate 2005 financial information based on Telecom Italia Group's share is as follows:

|  | As of<br>December 31,<br>2005 |
|--|-------------------------------|
|  | (millions of Euro)            |
| Non-current assets                             | 938                           |
| Current assets                                 | 269                           |
|  | 1,207                         |
| <b>Total assets</b>                            | <b>1,207</b>                  |
| Non-current liabilities                        | 767                           |
| Current liabilities                            | 299                           |
|  | 1,066                         |
| <b>Total liabilities</b>                       | <b>1,066</b>                  |
| Revenues                                       | 787                           |
| Operating income                               | 65                            |
| Income from continuing operations before taxes | 207                           |
| <b>Net income (loss)</b>                       | <b>54</b>                     |

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The list of companies accounted for using the equity method is presented in Note 41 List of companies of the Telecom Italia Group .

**Equity investments in other companies** are presented below:

|                              | As of<br>January 1,<br>2004 | Discontinued<br>operations/<br>assets held<br>for sale | Investments | Disposals and<br>capital<br>reimbursements | Fair value<br>adjustments | Reclassifications<br>and other<br>changes | As of<br>December 31,<br>2004 |
|------------------------------|-----------------------------|--|-------------|--|---------------------------|---|-------------------------------|
| (millions of Euro)           |                             |  |             |  |                           |   |                               |
| Brasil Telecom Participações |                             |  |             |  |                           | 17  | 17                            |
| CMobil                       | 9                           |  |             |  |                           |   | 9                             |
| Cirsa                        | 41                          |  |             | (41)                                       |                           |   |                               |
| Consortium                   | 20                          |  |             |  |                           |   | 20                            |
| Euskaltel                    | 27                          |  |             | (14)                                       |                           |   | 13                            |
| Fin. Priv.                   | 15                          |  |             |  |                           |   | 15                            |
| Forthnet                     | 11                          |  |             |  | (1)                       |   | 10                            |
| Mediobanca                   | 123                         |  |             |  | 45                        |   | 168                           |
| Medio Credito Centrale       | 36                          |  |             |  |                           |   | 36                            |
| Neuf Telecom                 | 51                          |  |             |  |                           |   | 51                            |
| Pirelli Real Estate          | 20                          |  |             | (20)                                       |                           |   |                               |
| Sia                          | 11                          |  |             |  |                           |   | 11                            |
| Solpart Participações        | 112                         |  |             |  |                           | (17)                                      | 95                            |
| Other                        | 47                          | (1)  | 1           | (13)                                       |                           |   | 34                            |
| <b>Total</b>                 | <b>523</b>                  | <b>(1)</b>   | <b>1</b>    | <b>(88)</b>                                | <b>44</b>                 |   | <b>479</b>                    |

|                              | As of<br>December 31,<br>2004 | Discontinued<br>operations/<br>assets held<br>for sale | Investments | Disposals and<br>capital<br>reimbursements | Fair value<br>adjustments | Reclassifications<br>and other<br>changes | As of<br>December 31,<br>2005 |
|------------------------------|-------------------------------|--|-------------|--|---------------------------|---|-------------------------------|
| (millions of Euro)           |                               |  |             |  |                           |   |                               |
| Brasil Telecom Participações | 17                            |  |             |  |                           | (17)                                      |                               |
| CMobil                       | 9                             |  |             | (9)  |                           |   |                               |
| Consortium                   | 20                            |  |             |  |                           |   | 20                            |
| Euskaltel                    | 13                            |  |             | (13)                                       |                           |   |                               |
| Fin. Priv.                   | 15                            |  |             |  |                           |   | 15                            |
| Forthnet                     | 10                            |  |             | (10)                                       |                           |   |                               |
| Mediobanca                   | 168                           |  |             |  | 59                        |   | 227                           |
| Medio Credito Centrale       | 36                            |  |             |  |                           |   | 36                            |

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|               |            |             |            |             |           |              |            |
|---------------|------------|-------------|------------|-------------|-----------|--------------|------------|
| Neuf Telecom  | 51         |             |            |             |           |              | 51         |
| Oger Telecom  |            |             | 178        |             |           |              | 178        |
| Sia           | 11         |             |            |             |           |              | 11         |
| Solpart       |            |             |            |             |           |              |            |
| Participações | 95         |             |            |             |           | (95)         |            |
| Other         | 34         | (11)        | 4          | (4)         |           |              | 23         |
| <b>Total</b>  | <b>479</b> | <b>(11)</b> | <b>182</b> | <b>(36)</b> | <b>59</b> | <b>(112)</b> | <b>561</b> |

**Equity investments in other companies** increased by 82 million in 2005 mainly as a result of the investment in Oger Telecom and the fair value adjustment of the investment in Mediobanca which was partly offset by the reclassification of Solpart and Brasil Telecom to equity investments in associates.

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**Financial receivables and other non-current financial assets** increased by 602 million and include the following:

|   | As of December 31, |            |
|---|--------------------|------------|
|   | 2004               | 2005       |
|   | (millions of Euro) |            |
| Financial receivables for lessors net investments   | 173                | 212        |
| Loans to employees  | 74                 | 79         |
| Hedging derivatives relating to hedged items classified as non-current assets/liabilities of a financial nature | 71                 | 276        |
| Other financial receivables   | 68                 | 421        |
|   | <b>386</b>         | <b>988</b> |

Financial receivables for lessors net investments refer to the non-current portion of Teleleasing lease contracts directly negotiated with customers and guaranteed by Telecom Italia. Financial receivables for lessors net investments also include, the non-current portion of finance lease contracts with customers (which also include the performance of accessory services under the full rent formula) relating to assets held under lease contracts.

|                     | As of December 31, |            |
|---------------------|--------------------|------------|
|                     | 2004               | 2005       |
|                     | (millions of Euro) |            |
| Non-current portion | 173                | 212        |
| Current portion     | 110                | 122        |
| <b>Total</b>        | <b>283</b>         | <b>334</b> |

Other financial receivables at the end of 2005 include 327 million of deposits at ABN Amro to guarantee the payment that Telecom Italia is required to make to Opportunity, subject to the occurrence of the conditions included in the contract for the purchase of Opportunity Zain (which indirectly holds Solpart Participações shares), and Brasil Telecom Participações shares, and 43 million (73 million at December 31, 2004) of the medium/long-term portion of the receivable due from PTT Srbija on the sale of Telekom Srbija.

**Miscellaneous receivables and other non-current assets** decreased from 881 million to 825 million and include the fair value of the two call options on 50% of Sofora share capital for 160 million (115 million at December 31, 2004), the tax credit from the advance payment of tax on the employee severance indemnities of 35 million (41 million at December 31, 2004) and prepaid expenses relating to the deferral of costs in conjunction with the recognition of revenues of 467 million (500 million at December 31, 2004).



**NOTE 10 DEFERRED TAX ASSETS AND RESERVE FOR DEFERRED TAXES**

Net deferred tax assets decreased from 3,944 million to 2,656 million and are presented in the balance sheet as follows:

|                            | <u>As of December 31,</u> |              |
|----------------------------|---------------------------|--------------|
|                            | <u>2004</u>               | <u>2005</u>  |
|                            | (millions of Euro)        |              |
| Deferred tax assets        | 4,114                     | 2,793        |
| Reserve for deferred taxes | (170)                     | (137)        |
| <b>Total</b>               | <b>3,944</b>              | <b>2,656</b> |

Since deferred tax assets and liabilities are reported, net of the offsets where applicable, made by each legal entity, their composition gross of offsets is presented below:

|                            | <u>As of December 31,</u> |              |
|----------------------------|---------------------------|--------------|
|                            | <u>2004</u>               | <u>2005</u>  |
|                            | (millions of Euro)        |              |
| Deferred tax assets        | 4,176                     | 3,044        |
| Reserve for deferred taxes | (232)                     | (388)        |
| <b>Total</b>               | <b>3,944</b>              | <b>2,656</b> |

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Changes in deferred tax assets and liabilities gave rise to a tax charge for the year ended December 31, 2005 of 1,386 million (see the Note 37 Income taxes for the year for additional details on the tax charge). The tax effect on the income and charges recognized directly in equity in 2005 is a charge of 1 million which is included in the Statement of changes in shareholders' equity for the year 2005.

The other changes during the year in deferred taxes which did not have an effect on net income mainly refer to the reduction in deferred tax liabilities ( 99 million) on the call option component of the Telecom Italia 1.5% 2001-2010 convertible bonds with a repayment premium which is lower in 2005 owing to the conversion to shares (see the Note 17 Shareholders' equity ) and to the deferred tax liabilities recorded on the business combinations recognized according to IFRS 3 ( 46 million, of which 41 million relates to the purchase of Elefante TV-Delta TV and 5 million to the purchase of Liberty Surf Group S.A.).

Temporary differences which make up this caption at December 31, 2005 and 2004 are the following:

|  | <b>As of December 31,</b> |              |
|--|---------------------------|--------------|
|  | <b>2004</b>               | <b>2005</b>  |
|  | <b>(millions of Euro)</b> |              |
| <b>Deferred tax assets:</b>  |                           |              |
| • Write-downs for the impairment of equity investments and other   | 2,310                     | 1,259        |
| • Unrealized intra-group gains                                     | 92                        | 31           |
| • Reserve for pension fund integration (Law No. 58/92)             | 292                       | 227          |
| • Tax loss carryforwards   | 538                       | 517          |
| • Reserves for risks and future charges                            | 253                       | 276          |
| • Bad debts reserve  | 159                       | 220          |
| • Recognition of revenues  | 181                       | 177          |
| • Sale and lease back transactions on properties                   | 92                        | 109          |
| • Derivative instruments   | 99                        | 130          |
| • Other deferred tax assets  | 160                       | 98           |
| <b>Total</b>   | <b>4,176</b>              | <b>3,044</b> |
| <b>Reserve for deferred taxes:</b>                                 |                           |              |
| • Accelerated depreciation   | (219)                     | (280)        |
| • Deferred gains   | (13)                      | (108)        |
| <b>Total</b>   | <b>(232)</b>              | <b>(388)</b> |
| <b>Total deferred tax assets net of reserve for deferred taxes</b> | <b>3,944</b>              | <b>2,656</b> |

Deferred tax assets on the write-downs for the impairment of equity investments refer to the write-downs recorded in prior years and deducted for tax purposes over a period of five years.

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At December 31, 2005, the Group had tax loss carryforwards mainly relating to the Parent, Telecom Italia, and some foreign companies (Telecom Italia Finance and TIM Celular) for a total amount of 7,304 million, with the following expiration dates:

| Year of expiration                  | (millions of Euro) |
|-------------------------------------|--------------------|
| 2006                                | 73                 |
| 2007                                | 140                |
| 2008                                | 1,818              |
| 2009                                | 59                 |
| 2010                                | 22                 |
| Expiration beyond 2010              | 5                  |
| Without expiration                  | 5,187              |
| <b>Total tax loss carryforwards</b> | <b>7,304</b>       |

At December 31, 2005, deferred tax assets have been recorded on tax loss carryforwards of 1,567 million. No deferred taxes have been calculated on the remaining tax losses ( 5,737 million) since their recoverability is not considered probable.

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At December 31, 2005, deferred taxes have not been recognized on tax-suspension reserves, subject to taxation in the event of distribution or utilization, in that their distribution or utilization is not foreseen.

Deferred taxes have not been recognized on the undistributed earnings of subsidiaries and associates in that the tax system of their parents provide for the participation exemption.

**NOTE 11 INVENTORIES**

**Inventories** decreased from 334 million at December 31, 2004 to 294 million. The composition of inventories is as follows:

|   | <u>As of December 31,</u> |             |
|---|---------------------------|-------------|
|   | <u>2004</u>               | <u>2005</u> |
|   | (millions of Euro)        |             |
| Raw materials and supplies                  | 12                        | 8           |
| Work in progress and semi-finished products | 16                        | 24          |
| Finished products                           | 306                       | 262         |
| <b>Total</b>                                | <b>334</b>                | <b>294</b>  |

Inventories include 105 million relating to the Mobile Business Unit (mobile equipment and accessories), 77 million to the Wireline Business Unit (telephone handsets) and 88 million to the Olivetti Business Unit (office products, specialized printers and gaming terminals).

Write-downs of inventories made in 2005 total 26 million and mainly refer to the adjustment of Wireline telephone handsets to estimated realizable value.

No inventories are pledged as collateral.

**NOTE 12 TRADE AND MISCELLANEOUS RECEIVABLES AND OTHER CURRENT ASSETS**

**Trade and miscellaneous receivables and other current assets** decreased from 10,155 million at December 31, 2004 to 9,191 million at December 31, 2005 and consist of the following:

|  | As of December 31, |              |
|--|--------------------|--------------|
|  | 2004               | 2005         |
|  | (millions of Euro) |              |
| <b>Receivables for construction contracts</b>              | <b>(A)</b>         |              |
|  | <b>39</b>          | <b>37</b>    |
| <b>Trade receivables:</b>                                  |                    |              |
| Amounts due from customers                                 | 6,556              | 5,960        |
| Amounts due from other telecommunication operators         | 1,145              | 978          |
|  | <b>(B)</b>         |              |
|  | <b>7,701</b>       | <b>6,938</b> |
| <b>Miscellaneous receivables and other current assets:</b> |                    |              |
| Other receivables  | 2,133              | 1,868        |
| Trade and miscellaneous prepaid expenses                   | 282                | 348          |
|  | <b>(C)</b>         |              |
|  | <b>2,415</b>       | <b>2,216</b> |
| <b>Total</b>   | <b>(A+B+C)</b>     |              |
|  | <b>10,155</b>      | <b>9,191</b> |

**Receivables on construction contracts** of 37 million mainly refer to Telecom Italia ( 20 million) for network equipment, Lombardy Region health cards and telephone plants customized for customers and Telecom Italia Learning Services S.p.A. ( 12 million) for training activities, conditional on the presentation of financial reports, prepared for projects carried out on behalf of local public entities.

**Trade receivables** amount to 6,938 million ( 7,701 million at December 31, 2004) and are net of the reserve for bad debts of 773 million ( 897 million at December 31, 2004).

The decrease is mainly due to the sale of the Entel Chile group, the Finsiel group, TIM Hellas and TIM Perù (for a total of 362 million).

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The decrease is also the result of the change in the contracts for the securitization of trade receivables from residential customers made at the end of 2005 which caused a reduction of 648 million. The change specifically refers to the full transfer of the risk on the deferred purchase price (DPP) which, together with the purchase of the securitization vehicle (TI Securitisation Vehicle) by a bank, led to the deconsolidation of this company with a consequent reduction in trade receivables.

The caption also includes 4 million ( 5 million at December 31, 2004) of medium/long-term trade receivables from customers.

Trade receivables specifically refer to Telecom Italia ( 4,001 million), Tim Italia ( 1,266 million) and the foreign mobile telephone companies ( 701 million).

Changes in the reserve for bad debts are as follows:

|   | <u>2004</u>        | <u>2005</u>       |
|---|--------------------|-------------------|
|   | (millions of Euro) |                   |
| At January 1,                                     | 905                | 897               |
| Discontinued operations                           | (23)               | (132)             |
| Charged to the statement of operations            | 295                | 264               |
| Utilization                                       | (266)              | (264)             |
| Reversal of the reserve in excess of requirements | (8)                | (15)              |
| Exchange differences and other changes            | (6)                | 23                |
| <b>At December 31,</b>                            | <b><u>897</u></b>  | <b><u>773</u></b> |

**Other receivables** amount to 1,868 million ( 2,133 million at December 31, 2004). Details are as follows:

|                            | <u>As of December 31,</u> |                     |
|----------------------------|---------------------------|---------------------|
|                            | <u>2004</u>               | <u>2005</u>         |
|                            | (millions of Euro)        |                     |
| Advances to supplier       | 45                        | 60                  |
| Receivables from employees | 60                        | 55                  |
| Tax receivables            | 699                       | 565                 |
| Miscellaneous receivables  | 1,329                     | 1,188               |
| <b>Total</b>               | <b><u>2,133</u></b>       | <b><u>1,868</u></b> |

**Tax receivables** include 335 million of current income taxes and 230 million of indirect duties and taxes. The decrease of 134 million is mainly the result of offsetting Ires receivables against Ires payables which became possible under the consolidated national tax return system.

**Miscellaneous receivables** comprise receivables of 634 million from the Financial Administration for the TLC operating fee paid by Telecom Italia and TIM for the year 1999, recognized in income in 2004 following the ruling by the TAR of Lazio Regional Administrative Court on January 4, 2005, and including interest due through December 31, 2005.

**Prepayments** of a trading and sundry nature regard the deferral of costs referring to the recognition of revenues.

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**Securities other than equity investments** decreased from 457 million at December 31, 2004 to 378 million. They consist of the following:

|   | <b>As of December 31,</b> |             |
|---|---------------------------|-------------|
|   | <b>2004</b>               | <b>2005</b> |
|   | <b>(millions of Euro)</b> |             |
| Held-to-maturity financial assets:  |                           |             |
| • Securities other than equity investments  |                           | 3           |
| Available-for-sale financial assets:  |                           |             |
| • Securities other than equity investments available for sale due beyond 3 months | 456                       | 374         |
| Financial assets at fair value through profit or loss:                            |                           |             |
| • Securities other than equity investments held for trading                       | 1                         | 1           |
| <b>Total</b>  | <b>457</b>                | <b>378</b>  |

Bonds and other securities amount to 378 million. They include 374 million invested by the Luxembourg subsidiary, Telecom Italia Finance S.A., in bonds issued by companies with at least an A rating and with different maturities, but all are actively traded and are, therefore, readily convertible to cash.

**NOTE 14 FINANCIAL RECEIVABLES AND OTHER CURRENT FINANCIAL ASSETS**

**Financial receivables and other current financial assets** decreased from 662 million at December 31, 2004 to 509 million. They consist of the following:

|   | <b>As of December 31,</b> |             |
|---|---------------------------|-------------|
|   | <b>2004</b>               | <b>2005</b> |
|   | <b>(millions of Euro)</b> |             |
| Deposits for temporary investments of excess liquidity originally due beyond 3 months but within 12 months  | 8                         | 90          |
| Financial receivables for lessors net investments   | 110                       | 122         |
| Other short-term financial receivables  | 489                       | 102         |
| Hedging derivatives relating to hedged items classified as current assets/liabilities of a financial nature | 55                        | 195         |



|              |            |            |
|--------------|------------|------------|
| <b>Total</b> | <u>662</u> | <u>509</u> |
|--------------|------------|------------|

**Deposits** refer to 80 million to investments of excess liquidity of Telecom Italia Finance S.A..

**Financial receivables for lessors net investments** refer to the current portion of Teleleasing lease contracts directly negotiated with customers and guaranteed by Telecom Italia. Such receivables also include the current portion of contracts to involving the sale of assets under finance leases to customers, including the performance of accessory services (the full rent formula).

**Other short-term financial receivables** include the current portion of loans to personnel for 10 million, the receivable from PTT Srbija on the sale of Telecom Srbija for 13 million and non-hedging derivatives for 61 million (102 million at December 31, 2004).

**Hedging derivatives relating to hedged items classified as current assets/liabilities of a financial nature** refer to accrued income on derivatives. Additional details are provided in the Note 23 Financial instruments .

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**Cash and cash equivalents** increased from 8,855 million at December 31, 2004 to 10,323 million. They consist of the following:

|   | <b>As of December 31,</b> |               |
|---|---------------------------|---------------|
|   | <b>2004</b>               | <b>2005</b>   |
|   | <b>(millions of Euro)</b> |               |
| Liquid assets with banks, financial institutions and post offices | 8,502                     | 9,956         |
| Cheques   | 1                         |               |
| Cash  | 3                         | 2             |
| Other receivables and current accounts                            | 20                        | 34            |
| Securities other than equity investments (due within 3 months)    | 329                       | 331           |
|   | <b>8,855</b>              | <b>10,323</b> |

The different technical forms used for the investment of available resources as of December 31, 2005 can be further analyzed as follows:

- **Maturities.** More than 97% of deposits have a maximum maturity date of two months.
- **Counterpart risk.** Deposits are made with leading banks and financial institutions with credit rating at least equal to A.
- **Country risk.** The geographic location of deposits is principally on the London financial market.

**Securities other than equity investments** (due within 3 months) include 327 million ( 329 million at December 31, 2004) of Euro Commercial Paper of Telecom Italia Finance S.A., of which 297 million maturing within two months and 30 million maturing up to February 16, 2006. The issuers all have AAA, AA and A ratings and are located in Europe.

**NOTE 16 DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE**

Discontinued operations/assets held for sale, at December 31, 2005, include the Entel Chile group (sold in March 2005), the Finsiel group and TIM Hellas (sold in June 2005), TIM Perù (sold in August 2005), the Gruppo Buffetti (sold in January 2006) and Corporacion Digitel (company held for sale).

As regards the data of the year ended December 31, 2004, presented for comparison purposes:

- as required by IFRS 5, discontinued operations/assets held for sale and related liabilities in the balance sheet as of December 31, 2004 include the companies so classified at that date (Finsiel group and Corporacion Digitel);
- the adjusted balance sheet at December 31, 2004 used for comparative purposes includes the assets and liabilities of the Finsiel group, Corporacion Digitel, Entel Chile group, TIM Hellas, TIM Perù and Gruppo Buffetti in discontinued operations/assets held for sale;
- the statement of operations and the statement of cash flows for the year 2004 have been prepared consistently with those of the 2005 statements taking into account all the discontinued operations/assets held for sale (and the related liabilities) at the end of 2005.

The balance sheet amounts relating to discontinued operations/assets held for sale are presented in two separate captions Discontinued operations/assets held for sale and Liabilities relating to discontinued operations/assets held for sale .

The result of operations and cash flows of discontinued operation/assets held for sale (and related liabilities) are presented in the captions Net income (loss) from discontinued operations/assets held for sale in the statement of operations and Cash flow generated by (used in) discontinued operations/assets held for sale in the statement of cash flows.

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***Sale of Entel Chile***

On March 29, 2005, Telecom Italia, through its subsidiary Telecom Italia International N.V., sold its 54.76% investment in the Chilean company Entel Chile S.A. to Almendral S.A. (an investment holding company listed on the stock exchange in Santiago, Chile which represents local businesses including the Hurtado Vicuña group and the Matte group).

The sales price was U.S.\$934 million ( 723 million) with a loss of 1 million and 6 million of transaction charges.

***Sale of Finsiel***

On April 26, 2005, the contract was finalized for the sale of the entire interest held by Telecom Italia in Finsiel (79.5%) to the COS group. The sale is based on an enterprise value of 164 million. The sales terms are as follows:

- on June 28, 2005, a 59.6% interest was sold for a price of 87 million;
- on November 7, 2005, the remaining 19.9% was sold for a price of 28 million.

The sale had no effect on the statement of operations since the carrying value had been adjusted to the sales price.

The residual receivable from the COS group for the sale of the investment is equal to 26 million and is scheduled to be collected by December 31, 2006.

***Sale of TIM Hellas***

On June 15, 2005, TIM International N.V. sold its 80.87% investment in TIM Hellas Telecommunications S.A. to the funds managed by Apax Partners and Texas Pacific group (TPG) for a price of 1,114 million corresponding to an enterprise value of approximately 1,600 million for 100% of TIM Hellas or approximately 16.43 per share. The sale gave rise to a net gain of 410 million.

***Sale of TIM Perú***

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On August 10, 2005, TIM International N.V. sold the entire investment in TIM Perù S.A.C. to Sercotel S.A. de C.V., a company controlled 100% by America Movil S.A. de C.V. for 330 million. The sale gave rise to a net gain of 120 million (net of the relative incidental charges) and a reduction in the net financial position of more than 400 million.

### ***Agreement for the sale of the Gruppo Buffetti***

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 its 100% stake held in Gruppo Buffetti S.p.A.. The transaction was finalized in January 2006 for a total amount of 76 million (enterprise value). In the 2005 financial statements, the investment value was already adjusted to the sales price and resulting in a charge of 6 million, included in net income attributable to the Group.

### ***Agreement for the sale of Corporacion Digitel***

The agreement signed with the local wireline telephone Cantv (Compañía Anonima Nacional Telefonos de Venezuela) in November 2004 for the sale of Corporacion Digitel was terminated after failure to receive authorization for the sale from the Venezuelan telecommunication authority on May 5, 2005.

On January 19, 2006, Telecom Italia, signed an agreement for the sale of 100% of the capital of Corporacion Digitel to the company Telvenco S.A. for a global value transaction of U.S.\$425 million (enterprise value). The closing of the transaction is subject mainly to the obtainment of the necessary authorizations from the relevant Venezuelan authorities.

Key figures relating to discontinued operations/assets held for sale in the balance sheet and statement of operations are presented below.

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The composition of **discontinued operations/assets held for sale** (and the related liabilities) is provided in the following table:

|   | As of December 31, |              |            |
|---|--------------------|--------------|------------|
|   | 2004               |              |            |
|   | 2004               | Adjusted     | 2005       |
|   | (millions of Euro) |              |            |
| Discontinued operations/Assets held for sale:                         |                    |              |            |
| • of a financial nature   | 84                 | 225          | 37         |
| • of a non-financial nature   | 1,096              | 4,494        | 491        |
| <b>Total</b>  | <b>1,180</b>       | <b>4,719</b> | <b>528</b> |
| Liabilities relating to discontinued operations/assets held for sale: |                    |              |            |
| • of a financial nature   | 188                | 1,023        | 143        |
| • of a non-financial nature   | 584                | 1,220        | 142        |
| <b>Total</b>  | <b>772</b>         | <b>2,243</b> | <b>285</b> |

**Discontinued operations/assets held for sale of a financial nature** refer to:

**Non-current financial assets**

|                   | As of December 31, |           |      |
|-------------------|--------------------|-----------|------|
|                   | 2004               |           |      |
|                   | 2004               | Adjusted  | 2005 |
|                   | (millions of Euro) |           |      |
| Entel Chile group |                    | 10        |      |
| Finsiel group     | 4                  | 4         |      |
|                   | <b>4</b>           | <b>14</b> |      |

**Current financial assets**

|                     | As of December 31, |            |           |
|---------------------|--------------------|------------|-----------|
|                     | 2004               |            |           |
|                     | 2004               | Adjusted   | 2005      |
|                     | (millions of Euro) |            |           |
| Entel Chile group   |                    | 112        |           |
| Finsiel group       | 36                 | 36         |           |
| TIM Hellas          |                    | 14         |           |
| TIM Perù            |                    | 3          |           |
| Gruppo Buffetti     |                    | 2          | 4         |
| Corporacion Digitel | 44                 | 44         | 33        |
|                     | <b>80</b>          | <b>211</b> | <b>37</b> |

**Assets of a non-financial nature** refer to:

|                     | As of December 31, |              |            |
|---------------------|--------------------|--------------|------------|
|                     | 2004               |              |            |
|                     | 2004               | Adjusted     | 2005       |
|                     | (millions of Euro) |              |            |
| Entel Chile group   |                    | 1,668        |            |
| Finsiel group       | 759                | 759          |            |
| TIM Hellas          |                    | 1,240        |            |
| TIM Perù            |                    | 358          |            |
| Gruppo Buffetti     |                    | 132          | 113        |
| Corporacion Digitel | 337                | 337          | 378        |
|                     | <b>1,096</b>       | <b>4,494</b> | <b>491</b> |

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At December 31, 2005, the item includes goodwill of 171 million, of which 12 million refers to the Gruppo Buffetti (net of the write-down of 7 million to adjust the amount to the sale price) and 158 million to Corporacion Digitel, with an increase of 36 million compared to January 1, 2004 for the purchase of the residual minority interest by TIM International.

At December 31, 2004 adjusted goodwill totaled 802 million, of which 371 million referred to the Entel Chile group, 273 million to TIM Hellas and 158 million to Corporacion Digitel.

**Liabilities of a financial nature** refer to:

**Non-current financial liabilities relating**

|                     | As of December 31, |            |           |
|---------------------|--------------------|------------|-----------|
|                     | 2004               |            |           |
|                     | 2004               | Adjusted   | 2005      |
|                     | (millions of Euro) |            |           |
| Entel Chile group   |                    | 499        |           |
| Finsiel group       | 7                  | 7          |           |
| TIM Hellas          |                    | 228        |           |
| TIM Perù            |                    | 82         |           |
| Gruppo Buffetti     |                    | 4          |           |
| Corporacion Digitel | 108                | 108        | 62        |
|                     | <b>115</b>         | <b>928</b> | <b>62</b> |

At December 31, 2004, adjusted non-current liabilities of a financial nature include 171 million for bonds issued by Entel Chile maturing between 2005 and 2023.

**Current liabilities of a financial nature**

|  | Year ended December 31, |      |      |
|--|-------------------------|------|------|
|  | 2004                    | 2004 | 2005 |
|  | Adjusted                |      |      |



|                     | (millions of Euro) |           |           |
|---------------------|--------------------|-----------|-----------|
| Finsiel group       | 19                 | 19        |           |
| Gruppo Buffetti     |                    | 22        | 19        |
| Corporacion Digitel | 54                 | 54        | 62        |
|                     | <u>73</u>          | <u>95</u> | <u>81</u> |

Liabilities of a non-financial nature refer to a:

|                     | Year ended December 31, |              |            |
|---------------------|-------------------------|--------------|------------|
|                     | 2004                    |              |            |
|                     | 2004                    | Adjusted     | 2005       |
|                     | (millions of Euro)      |              |            |
| Entel Chile group   |                         | 246          |            |
| Finsiel group       | 525                     | 524          |            |
| TIM Hellas          |                         | 274          |            |
| TIM Perù            |                         | 73           |            |
| Gruppo Buffetti     |                         | 44           | 40         |
| Corporacion Digitel | 59                      | 59           | 102        |
|                     | <u>584</u>              | <u>1,220</u> | <u>142</u> |

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The net income (loss) from discontinued operations/assets held for sale included in the statement of operations can be represented as follows:

|   | Year ended December 31, |            |
|---|-------------------------|------------|
|   | 2004                    | 2005       |
|   | (millions of Euro)      |            |
| <b>Economic effects from discontinued operations/assets held for sale:</b>        |                         |            |
| Revenues  | 2,935                   | 1,387      |
| Other income  | 39                      | 18         |
| Other operating expenses  | (2,324)                 | (1,127)    |
| Depreciation and amortization, gains/losses realized, impairment reversals/losses | (404)                   | (181)      |
| <b>Operating income</b>   | <b>246</b>              | <b>97</b>  |
| Net financial income (expenses)   | (64)                    | (22)       |
| <b>Income before taxes from discontinued operations/assets held for sale</b>      | <b>182</b>              | <b>75</b>  |
| Income taxes  | (81)                    | (31)       |
| <b>Income after taxes from discontinued operations/assets held for sale (A)</b>   | <b>101</b>              | <b>44</b>  |
| <b>Result of disposal:</b>  |                         |            |
| Write-downs/provisions relating to assets held for sale                           | (205)                   | (9)        |
| Net gain from discontinued operations   |                         | 515        |
| Income taxes  | (14)                    |            |
| <b>(B)</b>  | <b>(219)</b>            | <b>506</b> |
| <b>Net income (loss) from discontinued operations/assets held for sale (A+B)</b>  | <b>(118)</b>            | <b>550</b> |

A breakdown of the **income after taxes from discontinued operations/assets held for sale** is as follows:

|                   | Year ended December 31, |      |
|-------------------|-------------------------|------|
|                   | 2004                    | 2005 |
|                   | (millions of Euro)      |      |
| Entel Chile group | 49                      | 26   |
| Finsiel group     | (7)                     | (11) |
| TIM Hellas        | 82                      | 11   |
| TIM Perù          | (17)                    | (3)  |
| Gruppo Buffetti   | 1                       | 1    |

|                     |            |           |
|---------------------|------------|-----------|
| Corporacion Digitel | (7)        | 20        |
|                     | <u>101</u> | <u>44</u> |

A breakdown of the **results of disposal** is as follows:

|                     | <u>Year ended December 31,</u> |             |
|---------------------|--------------------------------|-------------|
|                     | <u>2004</u>                    | <u>2005</u> |
|                     | (millions of Euro)             |             |
| Entel Chile group   | (191)                          | (7)         |
| Finsiel group       | (28)                           | (8)         |
| TIM Hellas          |                                | 410         |
| TIM Perù            |                                | 120         |
| Gruppo Buffetti     |                                | (9)         |
| Corporacion Digitel |                                |             |
|                     | <u>(219)</u>                   | <u>506</u>  |

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Net cash flows from operating activities, investing activities and financing activities relating to discontinued operations/assets held for sale is as follows:

**Cash flows from operating activities**

|                                     | <b>Year ended December 31,</b> |             |
|-------------------------------------|--------------------------------|-------------|
|                                     | <b>2004</b>                    | <b>2005</b> |
|                                     | (millions of Euro)             |             |
| Entel Chile group                   | 289                            | 61          |
| Finsiel group                       | (45)                           | (12)        |
| TIM Hellas                          | 143                            | 27          |
| TIM Perù                            | 40                             | 21          |
| Gruppo Buffetti                     | 7                              | 11          |
| Corporacion Digitel                 | 58                             | 69          |
| Other, adjustments and eliminations | 13                             | 13          |
|                                     | <b>505</b>                     | <b>190</b>  |

**Cash flows from investing activities**

|                                     | <b>Year ended December 31,</b> |              |
|-------------------------------------|--------------------------------|--------------|
|                                     | <b>2004</b>                    | <b>2005</b>  |
|                                     | (millions of Euro)             |              |
| Entel Chile group                   | (98)                           | (12)         |
| Finsiel group                       | (20)                           | (3)          |
| TIM Hellas                          | (141)                          | (20)         |
| TIM Perù                            | (24)                           | (19)         |
| Gruppo Buffetti                     | (1)                            | (3)          |
| Corporacion Digitel                 | (21)                           | (47)         |
| Other, adjustments and eliminations | (31)                           | (20)         |
|                                     | <b>(336)</b>                   | <b>(124)</b> |

**Cash flows from financing activities**

|                                     | Year ended December 31, |      |
|-------------------------------------|-------------------------|------|
|                                     | 2004                    | 2005 |
|                                     | (millions of Euro)      |      |
| Entel Chile group                   | (190)                   | (2)  |
| Finsiel group                       | (21)                    | 15   |
| TIM Hellas                          | (55)                    | (17) |
| TIM Perù                            |                         | (8)  |
| Gruppo Buffetti                     |                         | (3)  |
| Corporacion Digitel                 | (12)                    | (32) |
| Other, adjustments and eliminations |                         | 7    |
|                                     | (278)                   | (40) |

**Total cash flows generated by (used in) discontinued operations/assets held for sale**

|   | Year ended December 31, |           |
|---|-------------------------|-----------|
|   | 2004                    | 2005      |
|   | (millions of Euro)      |           |
| Cash flows from operating activities  | 505                     | 190       |
| Cash flows from investing activities  | (336)                   | (124)     |
| Cash flows from financing activities  | (278)                   | (40)      |
| <b>Total cash flows generated by (used in) discontinued operations/assets held for sale</b> | <b>(109)</b>            | <b>26</b> |

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Shareholders equity includes:

|  | <u>As of December 31,</u> |               |
|--|---------------------------|---------------|
|  | <u>2004</u>               | <u>2005</u>   |
|  | (millions of Euro)        |               |
| Shareholders equity attributable to the Group          | 16,248                    | 25,662        |
| Shareholders equity attributable to Minority interests | 4,550                     | 1,323         |
|  | <u>20,798</u>             | <u>26,985</u> |

Shareholders equity attributable to the Group increased by 9,414 million compared to December 31, 2004. The increase is mainly due to the Telecom Italia/TIM merger ( 6,013 million), the conversion of 1,880,757,463 Telecom Italia 1.5% 2001-2010 convertible bonds ( 1,813 million) and the difference between dividends paid ( 1,912 million, net of dividends on shares held by Telecom Italia Finance), and the net income for the year ( 3,216 million).

Shareholders equity attributable to Minority interests decreased by 3,227 million, due to the Telecom Italia/TIM merger, the sale of the Entel Chile group, the Finsiel group, TIM Hellas and TIM Perù.

Changes of **Share capital** in the year 2005 are reported below:

**Reconciliation of outstanding shares as of December 31, 2004 to outstanding shares as of December 31, 2005**

|                      | <u>As of</u>        | <u>Issue of shares as a result of:</u> |                    |                   | <u>As of</u>        |
|----------------------|---------------------|--|--------------------|-------------------|---------------------|
|                      |                     | <u>Conversion</u>                      | <u>Exercise of</u> | <u>Telecom</u>    |                     |
|                      | <u>December 31,</u> | <u>of bonds</u>                        | <u>stock</u>       | <u>Italia-TIM</u> | <u>December 31,</u> |
|                      | <u>2004</u>         | <u>of bonds</u>                        | <u>options</u>     | <u>merger</u>     | <u>2005</u>         |
|                      | (number of shares)  |  |                    |                   |                     |
| Ordinary Shares      | 10,322,001,069      | 886,876,619                            | 10,657,408         | 2,150,947,060     | 13,370,482,156      |
| Less: treasury stock | (101,208,867)       |  |                    | (24,607,520)      | (125,816,387)       |

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|   |                       |                    |                   |                      |                       |
|---|-----------------------|--------------------|-------------------|----------------------|-----------------------|
| Outstanding Ordinary Shares                           | 10,220,792,202        | 886,876,619        | 10,657,408        | 2,126,339,540        | 13,244,665,769        |
| Savings Shares  | 5,795,921,069         |                    |                   | 230,199,592          | 6,026,120,661         |
| Less: Treasury Stock                                  |                       |                    |                   |                      |                       |
| Outstanding Savings Shares                            | 5,795,921,069         |                    |                   | 230,199,592          | 6,026,120,661         |
| <b>Total shares issued by Telecom Italia S.p.A.</b>   | <b>16,117,922,138</b> | <b>886,876,619</b> | <b>10,657,408</b> | <b>2,381,146,652</b> | <b>19,396,602,817</b> |
| Less: Treasury Stock                                  | (101,208,867)         |                    |                   | (24,607,520)         | (125,816,387)         |
| <b>Telecom Italia S.p.A. total outstanding shares</b> | <b>16,016,713,271</b> | <b>886,876,619</b> | <b>10,657,408</b> | <b>2,356,539,132</b> | <b>19,270,786,430</b> |

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|  | Share capital<br>as of<br>December 31,<br>2004 | Changes in Share capital as a result of: |                                 |                                 | Share capital<br>as of<br>December 31,<br>2005 |
|--|--|--|---------------------------------|---------------------------------|--|
|  |  | Conversion<br>of bonds                   | Exercise of<br>Stock<br>Options | Telecom<br>Italia-TIM<br>merger |  |
|  |  |  |                                 |                                 |  |
|  |  | (millions of Euro)                       |                                 |                                 |  |
| Ordinary Shares                                      | 5,677  | 488                                      | 6                               | 1,183                           | 7,354  |
| Less: treasury stock                                 | (56)   |  |                                 | (13)                            | (69)   |
| Outstanding Ordinary Shares                          | 5,621  | 488                                      | 6                               | 1,170                           | 7,285  |
| Outstanding Savings Shares                           | 3,188  |  |                                 | 126                             | 3,314  |
| <b>Share capital issued by Telecom Italia S.p.A.</b> | 8,865  | 488                                      | 6                               | 1,309                           | 10,668   |
| Less: Treasury Stock                                 | (56)   |  |                                 | (13)                            | (69)   |
| <b>Telecom Italia S.p.A. Share capital</b>           | <b>8,809</b>                                   | <b>488</b>                               | <b>6</b>                        | <b>1,296</b>                    | <b>10,599</b>                                  |

**Additional paid-in capital** is equal to 6,465 million as of December 31, 2005 and increased by 6,400 million compared to December 31, 2004. The increase refers to the following:

- an increase of 6,431 million due to the additional paid-in capital on the shares issued for the conversion of convertible bonds (for 1,640 million), the exercise of stock options (for 23 million) and the share capital increase to effect the merger of TIM into Telecom Italia (for 4,768 million);
- a decrease of 31 million due to external costs, net of the relative tax effect, referring to the merger of TIM into Telecom Italia.

**Reserve for net translation differences** shows a positive 793 million at December 31, 2005 (a negative 50 million at December 31, 2004) and mainly refers to the differences on the translation of the financial statements of the Brazilian mobile telephone companies to euro.

**Other income (charges) recognized directly in shareholders equity** is a negative 109 million at December 31, 2005 (a negative 107 million at December 31, 2004) and include:



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- a) Reserve for fair value adjustments of hedging instruments is a negative 216 million at December 31, 2005 (a negative 174 million at December 31, 2004), attributable to the Group negative for 234 million and other Group companies for 18 million. This reserve is expressed net of deferred tax assets of 95 million ( 90 million at December 31, 2004).

This reserve includes the current portion of gains or losses related to the fair value adjustment of derivative instruments designated to hedge the exposure of cash flow fluctuations relating to the assets or liabilities recorded in the financial statements (cash flow hedges).

- b) Reserve for fair value adjustments of available-for-sale financial assets is a positive 107 million (a positive 67 million at December 31, 2004) almost entirely attributable to the Group and refers to the measurement of Mediobanca shares at market price and is expressed net of deferred tax liabilities of 6 million.

**Other reserves** are a positive 3,835 million at December 31, 2005 (a positive 4,276 million at December 31, 2004) and include the other reserves of the Group net of the value of the treasury stock held by the Group and Telecom Italia Finance S.A. for the amount in excess of the relative par value which was deducted from Share capital .

Other reserves decreased principally due to the reduction of 315 million in Reserves for other equity instruments following the conversion of 1,880,757,463 bonds.

**Retained earnings (accumulated losses), including net income for the year** are a positive 4,079 million at December 31, 2005 (a positive 3,255 million at December 31, 2004) and include the net income for the year attributable to the Group, equal to 3,216 million ( 1,815 million in 2004), net of dividends declared of 1,912 million ( 1,730 million in 2004).

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Dividends payable to Ordinary and Savings shareholders are, respectively, 1,215 million ( 0.1093 per share) and 697 million ( 0.1203 per share).

**Shareholders equity attributable to Minority interests**, equal to 1,323 million ( 4,550 million at December 31, 2004), includes the Net income attributable to the Minority interests , equal to 474 million ( 1,019 million in 2004) and shows a decrease compared to December 31, 2004 mainly as a result of the merger of Telecom Italia/TIM ( 3,226 million). This item principally consists of the net equity attributable to the minority shareholders of the Mobile and Media Business Units.

The following table shows the future potential change in share capital by reason of the convertible notes and options and stock option plans still outstanding at December 31, 2005:

|   | <b>Bonds/<br/>options<br/>outstanding at<br/>12/31/2005</b> | <b>Conversion/<br/>Assignment<br/>ratio</b> | <b>Maximum<br/>number of<br/>shares that<br/>can be<br/>issued</b> | <b>Nominal<br/>value<br/>(thousand<br/>of<br/>Euro)</b> | <b>Additional<br/>paid in<br/>capital<br/>(thousand<br/>of<br/>Euro)</b> | <b>Subscription<br/>price<br/>per share<br/>(Euro)</b> |
|---|---|---|--|---|--|--|
| <b>Additional increases voted (Ordinary Shares)</b>         |   |   |  |   |  |  |
| Telecom Italia 1.5% 2001 2010 notes                         | 506,707,677.00  | 0.471553                                    | 238,939,525  | 131,417   | 375,291  |  |
| Stock Option Plan 2000                                      | 10,699,996.00   | 3.300871                                    | 35,319,216   | 19,426  | 128,394  | 4.185259   |
| Stock Option Plan 2001                                      | 31,862,500.00   | 3.300871                                    | 105,173,383  | 57,845  | 276,327  | 3.177343   |
| Stock Option Plan 2002 Top                                  | 9,480,001.33  | 3.300871                                    | 31,292,243   | 17,211  | 70,034   | 2.788052   |
| Stock Option Plan 2002                                      | 20,624,053.93   | 3.300871                                    | 68,076,920   | 37,442  | 160,656  |  |
| <i>Of which:</i>  |   |   |  |   |  |  |
| Assignment in March 2002                                    | 19,905,053.50   | 3.300871                                    | 65,703,601   | 36,137  | 156,244  | 2.928015   |
| Assignment in August 2002                                   | 719,000.43  | 3.300871                                    | 2,373,319  | 1,305   | 4,412  | 2.409061   |
| Stock Option Plan 2000-2002 ex TIM                          | 11,735,653.00   | 1.73  | 20,302,679   | 11,166  | 64,176   | 3.710983   |
| Stock Option Plan 2002-2003 ex TIM                          | 22,025,000.00   | 1.73  | 38,103,250   | 20,957  | 103,925  | 3.277457   |
| Stock Option Plan 2003-2005 ex TIM                          | 1,915,900.00  | 1.73  | 3,314,507  | 1,823   | 7,891  | 2.930636   |
| <b>Total additional increases voted (Ordinary Shares)</b>   |   |   | <b>540,521,723</b>   | <b>297,287</b>  | <b>1,186,694</b>   |  |
| <b>Additional increases not yet voted (Ordinary Shares)</b> |   |   | <b>1,600,000,000</b>   | <b>880,000</b>  |  |  |

With regard to the Telecom Italia 1.5% 2001 2010 convertible notes with a repayment premium , it should be noted that the number of outstanding notes at December 31, 2005 includes No. 8,591 notes for which the conversion to shares had already been requested. On January 13, 2006, the corresponding No. 4,049 Ordinary Shares were issued for a total par value of 2.2 thousand and additional paid-in capital of 6.4 thousand.

Additional details on the stock option plans are disclosed in the Note 39 Other information letter e .

The Shareholders Meeting of May 6, 2004 also granted the Board of Directors the right (which, to date, has not been exercised), for a maximum period of five years beginning May 6, 2004, to increase against payment, at one or more times, the share capital for a maximum total amount of 880,000,000, through the issue of a maximum of No. 1,600,000,000 Ordinary Shares, in whole or in part:

- (i) to be offered as option rights to the shareholders and convertible noteholders, or
- (ii) to be offered for subscription to the employees of Telecom Italia S.p.A. or to the companies which it controls, with the exclusion of the pre-emptive rights, pursuant to the combined provision of art. 2441, last paragraph, of the Italian Civil Code, and art. 134, second paragraph, of Legislative Decree No. 58/1998.

The resolutions for capital increases passed by the Board of Directors in exercising the aforementioned right shall establish the subscription price (including any additional paid-in-capital) and shall fix a specific deadline for the

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subscription of the share. They may also provide that, in the event the increase voted by the Board is not subscribed to by the deadline, the Share capital shall be increased for an amount equal to the subscriptions received up to that deadline date.

On the basis of the motion by the Board of Directors Meeting held on March 7, 2006, the net income for the year 2005 resulting from the separate financial statements of the Parent Company, Telecom Italia S.p.A., equal to 3,885 million, will be appropriated as dividends for 2,857 million for distribution to the shareholders:

- 0.1400 for each Ordinary Share;
- 0.1510 for each Savings Share;

before withholdings as established by law; undistributed net income will be appropriated from retained earnings.

**NOTE 18 FINANCIAL LIABILITIES (CURRENT AND NON-CURRENT)**

|   | As of December 31, |               |
|---|--------------------|---------------|
|   | 2004               | 2005          |
|   | (millions of Euro) |               |
| <b>Financial payables (medium/long-term):</b>   |                    |               |
| • Notes/bonds   | 30,060             | 29,281        |
| • Convertible and exchangeable notes/bonds  | 4,290              | 476           |
|   | <b>34,350</b>      | <b>29,757</b> |
| • Amounts due to banks  | 891                | 9,462         |
| • Hedging derivatives relating to hedged items classified as non-current assets/liabilities of a financial nature | 1,256              | 730           |
| • Other financial payables  | 365                | 303           |
|   | <b>36,862</b>      | <b>40,252</b> |
| • Finance lease liabilities (medium/long-term)  | 1,860              | 1,894         |
| • Other financial liabilities (medium/long-term)  | 3                  |               |
|   | <b>1,863</b>       | <b>1,894</b>  |
| <b>Total non current financial liabilities (A)</b>  | <b>38,725</b>      | <b>42,146</b> |
| <b>Financial payables (short-term):</b>   |                    |               |

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|   |               |               |
|---|---------------|---------------|
| • Notes and Bonds   | 1,058         | 6,181         |
| • Convertible and exchangeable notes and bonds  | 816           | 2,043         |
|   | <u>1,874</u>  | <u>8,224</u>  |
| • Amounts due to banks  | 746           | 646           |
| • Hedging derivatives relating to hedged items classified as current assets/liabilities of a financial nature | 83            | 185           |
| • Non-hedging derivatives   | 113           | 64            |
| • Other financial payables  | 1,352         | 453           |
|   | <u>4,168</u>  | <u>9,572</u>  |
| • Finance lease liabilities   | 227           | 234           |
| • Other financial liabilities   | 5             | 6             |
|   | <u>4,400</u>  | <u>9,812</u>  |
| <b>Total current financial liabilities (B)</b>  | <b>4,400</b>  | <b>9,812</b>  |
|   | <u>43,125</u> | <u>51,958</u> |
| <b>Total financial liabilities (C)=(A)+(B)</b>  | <b>43,125</b> | <b>51,958</b> |
|   | <u>188</u>    | <u>143</u>    |
| <b>Liabilities related to discontinued operations/assets held for sale (D)</b>                                | <b>188</b>    | <b>143</b>    |
|   | <u>43,313</u> | <u>52,101</u> |
| <b>Total gross financial debt (E)=(C)+(D)</b>   | <b>43,313</b> | <b>52,101</b> |

**Non-current financial liabilities** increased from 38,725 million to 42,146 million and current financial liabilities increased from 4,400 million to 9,812 million.

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**Notes and bonds** total 35,462 million ( 31,118 million at December 31, 2004) and increased by 4,344 million. Details are as follows:

|   | <b>As of December 31,</b> |               |
|---|---------------------------|---------------|
|   | <b>2004</b>               | <b>2005</b>   |
|   | <b>(millions of Euro)</b> |               |
| Non-current portion                                     | 30,060                    | 29,281        |
| Current portion   | 1,058                     | 6,181         |
| <b>Total book value</b>                                 | <b>31,118</b>             | <b>35,462</b> |
| Fair value adjustment and measurement at amortized cost | (941)                     | (885)         |
| <b>Total nominal repayment amount</b>                   | <b>30,177</b>             | <b>34,577</b> |

The nominal amount of principal, notes and bonds amount to 34,577 million and increased by 4,400 million compared to December 31, 2004 ( 30,177 million), mainly due to new notes/bond issues by Telecom Italia S.p.A. ( 2,580 million at December 31, 2005) and Telecom Italia Capital S.A. ( 2,119 million at December 31, 2005), reduced by the sale of Entel Chile ( 180 million of bonds at December 31, 2004) and the difference in the U.S. dollars/Euro exchange rate.

The regulations and/or Offering Circular relating to the notes and bonds described below are available on the corporate website <http://www.telecomitalia.it>.

Notes and bonds, expressed at the nominal amount of principal, refer to the following:

**Notes and bonds issued by Telecom Italia S.p.A. (for a total of 9,798 million):**

- notes for 2,500 million, issued on February 1, 2002, divided into two tranches of 1,250 million each, at annual fixed rates, respectively, with a coupon of 5.625%, maturing February 1, 2007 and with a coupon of 6.25%, maturing February 1, 2012;
- bonds 2002-2022 reserved for subscription by employees, in service or retired, of companies, directly and indirectly, controlled by Telecom Italia, with headquarters in Italy, for 248 million. The quarterly interest is payable in arrears on January 1 and July 1 of each year and is indexed to the 6-month Euribor;
- bonds for 3,000 million, issued on January 29, 2004, divided into three tranches: the first, for 1,000 million, with a quarterly coupon indexed to the 3-month Euribor + 0.33%, maturing October 29, 2007 (on December 21, 2005, the

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Board of Directors of Telecom Italia S.p.A. approved the early repayment of these bonds on the date of January 30, 2006); the second, for 750 million, with an annual fixed-rate coupon of 4.50%, maturing January 28, 2011; the third, for 1,250 million, with an annual fixed-rate coupon of 5.375%, maturing January 29, 2019;

- notes for 110 million issued on April 8, 2004 with a quarterly coupon equal to the 3-month Euribor + 0.60%, maturing March 30, 2009;
- bonds for GBP 850 million (equivalent to 1,240 million at December 31, 2005) issued on June 24, 2004, with an annual fixed-rate coupon of 6.375%, maturing June 24, 2019;
- bonds for 120 million issued on November 23, 2004 with a quarterly coupon equal to the 3-month Euribor + 0.66%, maturing November 23, 2015;
- bonds for 850 million issued on March 17, 2005 with an annual fixed-rate coupon of 5.25%, maturing March 17, 2055;
- notes for GBP 500 million (730 million at December 31, 2005) issued on June 29, 2005, with an annual fixed-rate coupon of 5.625%, maturing December 29, 2015;
- notes for 1,000 million issued on December 6, 2005 with a quarterly coupon equal to the 3-month Euribor + 0.53%, maturing December 6, 2012.

The notes issued in 2005 fall under Telecom Italia's Euro Medium Term Note Programme for 10 billion approved by the Board of Directors on October 10, 2003.

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- notes issued April 20, 2001 on international markets for a total of 6,000 million (the remaining amount is equal to 4,513 million). The issue is divided into three tranches: the first, for 1,000 million at quarterly floating interest rates, maturing April 20, 2004, and therefore already repaid; the second, for 3,000 million and currently equal to 2,513 million (on December 22, 2005, the bonds repurchased by Telecom Italia Finance S.A. were cancelled for a total of 487 million) with an annual fixed-rate coupon of 6.375%, maturing April 20, 2006; the third for 2,000 million with an annual fixed-rate coupon of 7.25%, maturing April 20, 2011;
- notes 1999-2009 for 1,500 million with an annual fixed-rate coupon of 5.15%, maturing in February 9, 2009;
- bonds 1986-2046 in Swiss francs originally issued for CHF 100 million and currently equal to CHF 88 million (56 million at December 31, 2005, net of the cancellation of the treasury bonds for CHF 12 million, equal to 8 million, on December 30, 2005) with an annual fixed-rate coupon of 5.625%, maturing June 12, 2046.

All of the bonds listed below were originally issued by Olivetti Finance N.V.S.A. (merged into Telecom Italia Finance S.A. effective June 1, 2004) and are guaranteed by Telecom Italia S.p.A.:

- notes denominated Telecom Italia Finance S.A. Euro 499,717,000 Guaranteed Floating Rate Extendable Notes Due 2006, maturing December 14, 2006, with a quarterly coupon indexed to the 3-month Euribor +130 basis points. In accordance with the terms and conditions of the extendable 2002-2005 notes, bondholders in possession of notes totaling 283,000 chose not to extend the maturity term of the notes on March 14, 2005 (original maturity date of the notes) and the company proceeded to repay the notes for that amount;
- notes 2002-2006 for 1,100 million and currently equal to 1,045 million (net of the notes repurchased in the year 2003 for a total of 55 million) with a quarterly coupon indexed to the 3-month Euribor + 1.25%, maturing January 3, 2006;
- notes 2002-2007 originally for 1,750 million and currently equal to 1,720 million (notes repurchased by Telecom Italia Finance S.A. were cancelled on December 22, 2005 for 30 million) with an annual fixed-rate coupon of 6.5%, maturing April 24, 2007;
- notes 2003-2008 originally for 1,750 million and currently equal to 1,674 million (notes repurchased by Telecom Italia Finance S.A. were cancelled on December 22, 2005 for 76 million) with an annual fixed-rate coupon of 5.875%, maturing January 24, 2008;
- notes 1999-2009 originally for 2,350 million and currently equal to 2,250 million (net of notes repurchased in 2002 for 100 million) with an annual fixed-rate coupon of 6.575%, maturing July 30, 2009;
- notes 2002-2012 for 1,000 million with an annual fixed-rate coupon of 7.25%, maturing April 24, 2012;



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- notes 2003-2013 for 850 million with an annual fixed-rate coupon of 6.875%, maturing January 24, 2013;
- bonds 2002-2032 for JPY 20 billion ( 144 million as of December 31, 2005) with a 6-month fixed-rate coupon of 3.55%, maturing May 14, 2032 (callable by the issuer annually beginning from May 14, 2012);
- bonds 2003-2033 of 1,050 million with an annual fixed-rate coupon of 7.75%, maturing January 24, 2033.

### **Notes and bonds issued by Telecom Italia Capital S.A. and guaranteed by Telecom Italia S.p.A. (for a total of 8,477 million):**

- issue of multi-tranche fixed-rate bonds on October 29, 2003, for U.S.\$4,000 million. The issue is divided into three tranches as follows:

U.S.\$1,000 million ( 848 million at December 31, 2005), with an annual fixed-rate coupon of 4%, maturing November 15, 2008;

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U.S.\$2,000 million ( 1,694 million at December 31, 2005), with an annual fixed-rate coupon of 5.25%, maturing November 15, 2013;

U.S.\$1,000 million ( 848 million at December 31, 2005), with an annual fixed-rate coupon of 6.375%, maturing November 15, 2033;

- issue of multi-tranche fixed-rate bonds on October 6, 2004, for U.S.\$3,500 million. The issue is divided into three tranches as follows:

U.S.\$1,250 million ( 1,060 million at December 31, 2005) with an annual fixed-rate coupon of 4%, maturing January 15, 2010;

U.S.\$1,250 million ( 1,060 million at December 31, 2005) with an annual fixed-rate coupon of 4.95%, maturing September 30, 2014;

U.S.\$1,000 million ( 848 million at December 31, 2005) with an annual fixed-rate coupon of 6%, maturing September 30, 2034;

- issue of multi-tranche fixed-rate notes on September 28, 2005 for U.S.\$2,500 million. The issue is divided into three tranches as follows:

U.S.\$700 million ( 593 million at December 31, 2005) with 4.875% annual fixed-rate interest with a semi-annual coupon, maturing October 1, 2010;

U.S.\$400 million ( 339 million at December 31, 2005) with a quarterly coupon indexed to the 3-month U.S.\$ Libor + 0.48%, maturing February 1, 2011;

U.S.\$1,400 million ( 1,187 million at December 31, 2005) with 5.25% annual fixed-rate interest with a semi-annual coupon, maturing October 1, 2015.

The following table shows the notes and bonds issued to third parties, expressed at the nominal repayment amount and the market value, issued by companies in the Telecom Italia Group and divided by issuing company:

| Original Currency                                      | Amount in original currency (million) | Nominal repayment amount in Euro (million) | Coupon (%)        | Issue date | Maturity date | Issue price (%) | Market price (%) | Market value (millions of Euro) |
|--|---------------------------------------|--|-------------------|------------|---------------|-----------------|------------------|---------------------------------|
| <b>Notes and bonds issued by Telecom Italia S.p.A.</b> |                                       |  |                   |            |               |                 |                  |                                 |
| 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                           |

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|      |       |       |                       |            |            |        |         |       |
|------|-------|-------|-----------------------|------------|------------|--------|---------|-------|
| 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   |

|                  |              |               |
|------------------|--------------|---------------|
| <b>Sub-Total</b> | <b>9,798</b> | <b>10,203</b> |
|------------------|--------------|---------------|

**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    |

|                  |               |               |
|------------------|---------------|---------------|
| <b>Sub-Total</b> | <b>16,302</b> | <b>17,846</b> |
|------------------|---------------|---------------|

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|--|---------------------------------------|--|--|------------|---------------|-----------------|------------------|---------------------------------|
| Original Currency  | Amount in original currency (million) | Nominal repayment amount in Euro (million) | Coupon (%)                                 | Issue date | Maturity date | Issue price (%) | Market price (%) | Market value (millions of Euro) |
| <b>Notes and bonds issued by Telecom Italia Capital S.A. and guaranteed by Telecom Italia S.p.A.</b> |                                       |  |  |            |               |                 |                  |                                 |
| 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  | 3 M 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                             |
| <b>Sub-Total</b>   |                                       | <b>8,477</b>                               |  |            |               |                 |                  | <b>8,259</b>                    |
| <b>Total</b>   |                                       | <b>34,577</b>                              |  |            |               |                 |                  | <b>36,308</b>                   |

Notes (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 (originally maturing on October 29, 2007).

(\*) Weighted average issue price for notes and bonds issued with more than one tranche.

**Mechanism describing how coupons change on step-up/step-down notes and bonds in relation to a change in the rating:**

At December 31, 2005, the rating agencies had made no changes to the ratings assigned at the time of the announcement of the merger of Telecom Italia and Tim on December 7, 2004.

|                    |      |                  |
|--------------------|------|------------------|
| Standard & Poor s: | BBB+ | stable outlook   |
| Moody s:           | Baa2 | stable outlook   |
| Fitch Ratings:     | A    | negative outlook |

**a) Telecom Italia Finance S.A.**

**Euro Notes :** 2,513 million, 6.375% interest, maturing April 2006

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**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).

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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%.

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:

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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%;
- 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, note-holders in possession of notes totaling 283,000 chose not to extend the maturity date. For those, instead,

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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.

**Convertible and exchangeable notes** amount to 2,519 million ( 5,106 million at December 31, 2004) and decreased by 2,587 million. They are composed as follows:

|   | As of December 31, |              |
|---|--------------------|--------------|
|   | 2004               | 2005         |
|   | (millions of Euro) |              |
| Non-current portion                                     | 4,290              | 476          |
| Current portion   | 816                | 2,043        |
| <b>Total book value</b>                                 | <b>5,106</b>       | <b>2,519</b> |
| Fair value adjustment and measurement at amortized cost | 833                | 123          |
| <b>Total nominal amount</b>                             | <b>5,939</b>       | <b>2,642</b> |

In terms of the nominal repayment amount, convertible and exchangeable notes amount to 2,642 million. This is a decrease of 3,297 million compared to December 31, 2004 ( 5,939 million) mainly on account of the requests for the conversion of Telecom Italia S.p.A. 1.5% 2001-2010 convertible notes with a repayment premium ( 2,225 million) and repurchases made by Telecom Italia Finance S.A. ( 229 million) and the repayment, on November 3, 2005 of exchangeable notes for 643.4 million (net of repurchases and inclusive of the repayment premium).

Notes, expressed at the nominal repayment amount, refer to the following:

- notes 2001-2010 issued by Telecom Italia S.p.A. convertible into Telecom Italia S.p.A. shares, with an annual fixed-rate coupon of 1.5% with a repayment premium equal to 118.37825% of the nominal amount of the bonds, maturing in January 2010. The remaining number of bonds outstanding at December 31, 2005 is equal to 506.7 million (at the nominal amount) corresponding to No. 238,935,476 Telecom Italia S.p.A. Ordinary Shares. These bonds thus result in a total debt of 599.8 million (inclusive of the repayment premium). The annual yield upon maturity is 3.5% and the conversion will be at a ratio of 0.471553 new Telecom Italia S.p.A. shares for each bond held;
- notes issued in March 2001 by Telecom Italia Finance S.A. for 2,500 million, convertible into TIM or Seat Pagine Gialle shares, with the right of the issuer to settle the amount due in cash in the event of a request for conversion. The notes have an annual fixed-rate coupon of 1% and a repayment premium of 117.69% of the issue price, maturing in March 2006. The notes decreased by 536 million in September 2002 due to the purchase of own notes by Telecom Italia Finance S.A. which were subsequently cancelled.



The right to an early repayment at the end of third year (March 2004) was exercised by investors for an amount of 466,000.

During 2005, Telecom Italia Finance S.A. repurchased its own notes for 229 million (in April and May 2005 for 195 million, in July 2005 for 5 million, in October and December 2005 for 9 million and 20 million, respectively), therefore, after cancellation of the entire amount of notes repurchased in December 22, 2005, the residual nominal debt at the end of 2005 is equal to 1,735 million (2,042 million with the repayment premium).

The spin-off transaction and the consequent disposal of the equity investment in the beneficiary company Nuova Seat Pagine Gialle in 2003, did not result in any changes in the terms of the notes since their conditions allowed ample flexibility in the method of settlement.

The notes were convertible into No. 181,461,941 TIM shares at an exercise price of about 10.823 and, at June 30, 2005, after the conclusion of the merger between Telecom Italia and TIM, the notes were convertible into either No. 313,929,158 Telecom Italia S.p.A. Ordinary Shares at an exercise price of about 6.256, or into Seat Pagine Gialle shares and TI Media shares. Following the TI Media capital increase

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against payment, the notes are now convertible into No. 707,460,852 Seat Pagine Gialle shares and No. 125,746,257 Telecom Italia Media shares at an exercise price of 2.357197842. The annual yield to maturity is 4.25% and the conversion will be in a ratio of No. 159.838963073 Telecom Italia S.p.A. shares or 360.2080473 Seat Pagine Gialle shares and No. 64.024481 Telecom Italia Media shares for each 1,000 bond held.

A summary of convertible and exchangeable notes held by third parties, expressed at the nominal repayment amount, issued by companies of the Telecom Italia Group and divided by issuing company is presented below:

| Original Currency   | Nominal repayment amount (millions of Euro) | Coupon | New shares issuers   | Issue date | Maturity date | Issue price (%) | Market price (%) | Market value (millions of Euro) |
|---|---|--------|--|------------|---------------|-----------------|------------------|---------------------------------|
| <b>Convertible notes issued by Telecom Italia S.p.A.</b>  |   |        |  |            |               |                 |                  |                                 |
| Euro  | 600   | 1.50%  | Telecom Italia S.p.A.  | 11/23/2001 | 01/01/2010    | 100             | 124.948          | 633                             |
| <b>Exchangeable notes issued by Telecom Italia Finance S.A. and guaranteed by Telecom Italia S.p.A.</b> |   |        |  |            |               |                 |                  |                                 |
| Euro  | 2,042                                       | 1.00%  | Telecom Italia S.p.A./<br>Telecom Italia Media<br>S.p.A./<br><br>Seat Pagine Gialle<br>S.p.A./ | 03/15/2001 | 03/15/2006    | 100             | 117.205          | 2,033                           |
| <b>Total</b>  | <b>2,642</b>                                |        |  |            |               |                 |                  | <b>2,666</b>                    |

**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 a 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 a SEC-registered exchange offer. The offer was executed on October 13, 2005, in fulfillment of the covenant.

Medium/long-term **amounts due to banks** of 9,462 million ( 891 million at December 31, 2004) increased by 8,571 million mainly as a result of the cash tender offer for TIM shares. In fact, on January 28, 2005, in connection with the payment of the consideration of the tender offer, in addition to 2,504 million paid from cash resources, 11,300 million was drawn from the loan made available by a syndicate of banks on December 8, 2004. On February 11, 2005, the first tranche of the loan was repaid in advance for 2,300 million from the cash

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resources of Telecom Italia and, consequently, cancelled. After that repayment, the outstanding loan amounts to a nominal value of 9,000 million divided into two tranches: 6,000 million due in 36 months (Tranche B) and 3,000 million due in 60 months (Tranche C). On August 1, 2005, Tranche B of this loan, maturing in January 2008, was replaced by a new revolving loan for the same amount with maturity extended to 2012, at better conditions. Tranche C, maturing in January 2010, instead, was changed only with respect to the margin which was lowered so that it would reflect the new better conditions offered by the market for syndicated loans. Subsequently, on October 20, 2005, 1.5 billion of the revolving loan for 6 billion, maturing in 2012, was repaid so that it was reduced to 4.5 billion.

Short-term amounts due to banks of 646 million decreased by 100 million ( 746 million at December 31, 2004).

**Hedging derivatives** relating to hedged items classified as non-current current assets/liabilities of a financial nature amount to 730 million ( 1,256 million at December 31, 2004), whereas those on current assets/liabilities of a financial nature amount to 185 million with an increase of 102 million compared to December 31, 2004 ( 83 million). Additional details are provided in the Note 23 Financial instruments .

Medium/long-term **other financial liabilities** amount to 303 million ( 365 million at December 31, 2004) and decreased by 62 million; they include 162 million of the Telecom Italia Finance S.A. loan for JPY 20,000 million maturing 2029, 42 million of payables to the *Cassa Depositi e Prestiti* and 64 million of payables to the Ministry of Industry. Short-term other financial liabilities amount to 453 million with a reduction of 899 million compared to December 31, 2004 ( 1,352 million); they include 60 million of payables to the *Cassa Depositi e Prestiti*, 110 million of payables for factoring transactions and 211 million of payables to the TI Securitization Vehicle.

Medium-long term **finance lease liabilities** totaling 1,894 million ( 1,860 million at December 31, 2004) increased by 34 million and mainly refer to building sale and leaseback transactions recorded in accordance with IAS 17. Short-term finance lease liabilities amount to 234 million with an increase of 7 million compared to December 31, 2004 ( 227 million).

Short-term **non-hedging derivatives** totaling 64 million ( 113 million at December 31, 2004) decreased by 49 million and refer to the measurement of derivatives which, although put into place for hedging purposes, do not possess the formal requisites to be considered as such under IFRS.

At December 31, 2005, the unused credit lines of the Telecom Italia Group amount to 8,227 million ( 20,880 million at December 31, 2004), of which unused committed credit lines amount to 5 billion, and 1.5 billion expiring, respectively in March 2007 and in August 2012. Approximately 97% of the credit lines is denominated in Euro and linked to a floating interest rate.

In the following tables, the debt positions of the discontinued operations/assets held for sale are shown separately.

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Gross accounting financial debt according to the original currency of the transaction, showing the major foreign currencies and the corresponding equivalent amount in euro, is the following:

|  | <b>As of December 31, 2005</b>            |                           |
|--|---|---------------------------|
|  | <b>(millions of<br/>foreign currency)</b> | <b>(millions of Euro)</b> |
| USD  | 10,351                                    | 8,774                     |
| GBP  | 1,365                                     | 1,991                     |
| BRL  | 1,898                                     | 687                       |
| JPY  | 19,888                                    | 143                       |
| CHF  | 90  | 58                        |
| EURO   |   | 40,305                    |
|  |   | <b>51,958</b>             |
| Discontinued operations/assets held for sale |   | 143                       |
|  |   | <b>52,101</b>             |

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The analysis of gross financial debt by effective interest rate bracket excluding the effect of derivative hedging instruments, if any, is the following:

|  | <b>As of<br/>December 31,<br/>2005</b> |
|--|--|
|  | <b>(millions of Euro)</b>              |
| Up to a 2.5%   | 9,328                                  |
| From 2.5% to 5%  | 9,055                                  |
| From 5% to 7.5%  | 25,218                                 |
| From 7.5% to 10%   | 5,752                                  |
| Over 10%   | 496                                    |
| Accruals, prepaid expenses, deferred income, MTM and derivatives | 2,109                                  |
|  | <b>51,958</b>                          |
| Discontinued operations/assets held for sale                     | 143                                    |
|  | <b>52,101</b>                          |

However, as a result of the use of derivative hedging instruments, gross financial debt by nominal interest rate bracket is the following:

|  | <b>As of<br/>December 31,<br/>2005</b> |
|--|--|
|  | <b>(millions of Euro)</b>              |
| Up to a 2.5%   | 8,270                                  |
| From 2.5% to 5%  | 18,883                                 |
| From 5% to 7.5%  | 19,432                                 |
| From 7.5% to 10%   | 2,766                                  |
| Over 10%   | 498                                    |
| Accruals, prepaid expenses, deferred income, MTM and derivatives | 2,109                                  |
|  | <b>51,958</b>                          |
| Discontinued operations/assets held for sale                     | 143                                    |
|  | <b>52,101</b>                          |

Gross financial debt by maturity date (divided between short-term and medium/long-term) as of December 31, 2005 is as follows:

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|  | <u>Medium/long<br/>term debt</u> | <u>Short-term<br/>debt</u> | <u>Total</u>  |
|--|----------------------------------|----------------------------|---------------|
|  | (millions of Euro)               |                            |               |
| 2006(*)                                      | 8,979                            | 833                        | 9,812         |
| 2007   | 3,734                            |                            | 3,734         |
| 2008   | 3,227                            |                            | 3,227         |
| 2009   | 4,309                            |                            | 4,309         |
| 2010   | 5,286                            |                            | 5,286         |
| Beyond 2010                                  | 25,590                           |                            | 25,590        |
|  | <u>51,125</u>                    | <u>833</u>                 | <u>51,958</u> |
| Discontinued operations/assets held for sale | 124                              | 19                         | 143           |
|  | <u>51,249</u>                    | <u>852</u>                 | <u>52,101</u> |

(\*) Current portion of medium/long-term debt.

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**NOTE 19 EMPLOYEE SEVERANCE INDEMNITIES AND OTHER EMPLOYEE-RELATED RESERVES**

**Employee severance indemnities and other employee-related reserves** increased from 1,292 million at December 31, 2004 to 1,494 million at December 31, 2005. Details are as follows:

|   |              | As of<br>December 31,<br>2004 | Discontinued<br>operations/<br>assets held<br>for sale | Increases  | Decreases    | Exchange<br>differences | As of<br>December 31,<br>2005 |
|---|--------------|-------------------------------|--|------------|--------------|-------------------------|-------------------------------|
| (millions of Euro)                                |              |                               |  |            |              |                         |                               |
| <b>Reserve for employee severance indemnities</b> | <b>(A)</b>   | <b>1,181</b>                  | <b>(4)</b>   | <b>168</b> | <b>(111)</b> |                         | <b>1,234</b>                  |
| Reserves for pension plans                        |              | 40                            | (10)   | 6          | (3)          | 1                       | 34                            |
| Reserve for termination incentives                |              | 71                            |  | 234        | (79)         |                         | 226                           |
| <b>Other employee-related reserves (*)</b>        | <b>(B)</b>   | <b>111</b>                    | <b>(10)</b>  | <b>240</b> | <b>(82)</b>  | <b>1</b>                | <b>260</b>                    |
| <b>Total</b>                                      | <b>(A+B)</b> | <b>1,292</b>                  | <b>(14)</b>  | <b>408</b> | <b>(193)</b> | <b>1</b>                | <b>1,494</b>                  |
| <i>Of which :</i>                                 |              |                               |  |            |              |                         |                               |
| <i>Non-current portion</i>                        |              | <i>1,222</i>                  |  |            |              |                         | <i>1,351</i>                  |
| <i>Current portion (*)</i>                        |              | <i>70</i>                     |  |            |              |                         | <i>143</i>                    |

**Employee severance indemnities** refer only to Italian Group companies. The reserve increased by 53 million mainly as a result of the charge to the statement of operations ( 168 million), utilizations for indemnities paid to employees who terminated employment, advances and transfers to pension funds ( 106 million) and other negative changes ( 9 million).

In accordance with IAS 19 Employee Benefits , the Projected Unit Credit Method was used to measure employee severance indemnities, as described below:

- the future possible benefits which could be paid to each employee in the event of retirement, death, disability, resignation etc. have been projected on the basis of a series of financial assumptions (cost-of-living increases, increase in remuneration etc.). The estimate of the future benefits include increases for additional service seniority as well as the estimated increase in the remuneration level at the measurement date;



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the *average present value of future benefits* has been calculated, at the measurement date, on the basis of the annual interest rate and on the expected payment date;

- the liability of the company has been determined as the average present value of future benefits for service matured by the employee at the measurement date.

The following assumptions were made:

| <b>Financial assumptions</b>                          | <b>Executives</b>           | <b>Other than Executives</b> |
|---|-----------------------------|------------------------------|
| Cost-of-living increase                               | 2.0% per annum              | 2.0% per annum               |
| Discount rate   | 4.0% per annum              | 4.0% per annum               |
| Remuneration increase (in relation to each company):  |                             |                              |
| age equal to or less than 40 years                    | From 3.0% to 3.5% per annum | From 3.0% to 3.25% per annum |
| age over 40 years, but equal to or less than 55 years | From 2.5% to 3.0% per annum | From 2.5% to 2.75% per annum |
| over 55 years of age                                  | From 2.0% to 2.5% per annum | From 2.0% to 2.25% per annum |

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|--|---|---|
| <u>Demographic assumptions</u>                         | <u>Executives</u>   | <u>Other than Executives</u>  |
| Death probability                                      | Mortality tables RG 48 published by Ragioneria Generale dello Stato | Mortality tables RG 48 published by Ragioneria Generale dello Stato |
| Disability probability                                 | Tables unisex published by C.N.R. reduced by 80%                    | Tables unisex published by C.N.R. reduced by 80%                    |
| Resignation probability (in relation to each company): |   |   |
| up to 40 years   | From 3.0% to 5.0% per annum   | From 3.0% to 5.0% per annum   |
| up to 50 years   | From 1.5% to 3.5% per annum   | From 1.5% to 3.5% per annum   |
| over 50 years  | None  | None  |
| Retirement probability:                                |   |   |
| 35 years of service (at the age of 57)                 | 35%   | 60%   |
| over 35 years of service (at the age of 65)            | 15%   | 10%   |
| at 65 years of age                                     | 100%  | 100%  |

The adoption of the above assumptions resulted in a liability for Employee severance indemnities at December 31, 2004 and 2005 of 1,181 million and 1,234 million, respectively.

The effect on the statement of operations is as follows:

|   | Year ended<br>December 31, |            |
|---|----------------------------|------------|
|   | 2004                       | 2005       |
|   | (millions of Euro)         |            |
| Current service cost                                    | 127                        | 134        |
| Interest expenses                                       | 57                         | 45         |
| Net actuarial (gains) losses recognized during the year |                            | (11)       |
| <b>Total expense</b>                                    | <b>184</b>                 | <b>168</b> |
| <b>Effective return on plan assets</b>                  | <b>n/a</b>                 | <b>n/a</b> |

**Reserves for pension plans** principally refer to pension plans operating in foreign companies of the Group.

**Reserve for termination incentives** includes provisions made both for agreements regarding mobility pursuant to Law No. 223/91, agreed in December 2005 with the labor unions, and the plan for the voluntary termination of managers for the cases currently pending.

Increases are net of the decrease deriving from the effect of discounting to present value of approximately 6 million.

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**NOTE 20 RESERVES FOR RISKS AND FUTURE CHARGES**

Reserves for risks and future charges decreased from 2,171 million at December 31, 2004 to 1,569 million at December 31, 2005. The composition and changes are as follows:

|  | As of<br>December 31,<br>2004 | Discontinued<br>operations/<br>assets held<br>for sale | Increases  | Decreases    | Exchange<br>differences | As of<br>December 31,<br>2005 |
|--|-------------------------------|--|------------|--------------|-------------------------|-------------------------------|
| (millions of Euro)   |                               |  |            |              |                         |                               |
| Reserve for taxation and tax risks   | 253                           | (19)   | 27         | (43)         | 8                       | 226                           |
| Reserve for restoration costs  | 375                           | (16)   | 70         | (15)         | 29                      | 443                           |
| Reserve for legal disputes   | 152                           | (14)   | 50         | (48)         | 8                       | 148                           |
| Reserve for commercial risks   | 103                           |  | 33         | (14)         |                         | 122                           |
| Reserves for risks and future charges on equity investments and corporate-related transactions | 916                           |  | 52         | (544)        | 5                       | 429                           |
| Other reserves for risks and future charges  | 372                           |  | 18         | (190)        | 1                       | 201                           |
| <b>Total</b>   | <b>2,171</b>                  | <b>(49)</b>  | <b>250</b> | <b>(854)</b> | <b>51</b>               | <b>1,569</b>                  |
| <i>Of which :</i>  |                               |  |            |              |                         |                               |
| <i>Current portion</i>   | <i>815</i>                    |  |            |              |                         | <i>797</i>                    |
| <i>Non-current portion</i>   | <i>1,356</i>                  |  |            |              |                         | <i>772</i>                    |

**Reserve for restoration costs** refers to the provision for the estimated cost to decommission tangible assets and restore the sites. Compared to December 31, 2004, the reserve increased mainly as a result of a higher number of sites leased and the change in the discount rates and for the charge in the statement of operations of the cumulative effect of discounting to present value in the amount of 14 million.

The reserve relates to Telecom Italia (129 million), Tim Italia (180 million) and other foreign mobile telephone companies (134 million).

**Reserves for risks and future charges on equity investments and corporate-related transactions** decreased by 487 million. The change is mainly due to the release of 423 million of reserves recorded for sureties provided to a group of banks which had financed AVEA I.H.A.S., due to the cancellation of the guarantees in part, and to 96 million for the release of the reserve previously recorded for the dispute with the minority shareholders of Med S.A., Med Ltd and Med1, settled in July 2005. At December 31, 2005, the residual reserve set aside for AVEA I.H.A.S. is equal to 121 million.

**Other reserves for risks and future charges** include 115 million for the fine levied against Telecom Italia by the Antitrust Authorities for the alleged abuse of a dominant position in the market. This reserve, recorded in 2004 for 152 million, was reduced by 37 million following the issuance of an order by the Council of State on February 10, 2006.

#### NOTE 21 MISCELLANEOUS PAYABLES AND OTHER NON-CURRENT LIABILITIES

Miscellaneous payables and other non-current liabilities decreased from 2,199 million at December 31, 2004 to 2,113 million at December 31, 2005 and consist of the following:

|  | As of December 31, |              |
|--|--------------------|--------------|
|  | 2004               | 2005         |
|  | (millions of Euro) |              |
| Amounts due to social security authorities | 1,035              | 881          |
| Capital grants                             | 206                | 170          |
| Medium/long-term deferred income           | 944                | 1,056        |
| Other payables and liabilities             | 14                 | 6            |
| <b>Total</b>                               | <b>2,199</b>       | <b>2,113</b> |

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Amounts due to social security authorities refer to the residual amount payable to INPS for estimated employee benefit obligations owed under Law No. 58/1992. Details are as follows:

|  | As of December 31, |              |
|--|--------------------|--------------|
|  | 2004               | 2005         |
|  | (millions of Euro) |              |
| <b>Non-current payables</b>                        |                    |              |
| Due from 2 to 5 years after the balance sheet date | 935                | 753          |
| Due beyond 5 years after the balance sheet date    | 100                | 128          |
|  | <b>1,035</b>       | <b>881</b>   |
| <b>Current payables</b>                            | <b>217</b>         | <b>213</b>   |
| <b>Total</b>                                       | <b>1,252</b>       | <b>1,094</b> |

Medium/long-term deferred income includes 759 million for the deferral of revenues from the activation of Telecom Italia telephone service and 265 million for revenues from the sale of transmission capacity referring in future years.

**NOTE 22 TRADE PAYABLES, TAX PAYABLES, MISCELLANEOUS PAYABLES AND OTHER CURRENT LIABILITIES**

**Trade payables, tax payables, miscellaneous payables and other current liabilities** decreased from 12,733 million as of December 31, 2004 to 12,384 million as of December 31, 2005.

|  | As of December 31, |              |
|--|--------------------|--------------|
|  | 2004               | 2005         |
|  | (millions of Euro) |              |
| <b>Trade payables:</b>                                       |                    |              |
| • Amounts due to suppliers                                   | 6,227              | 6,230        |
| • Amounts due to other telecommunication operators           | 643                | 606          |
|  | <b>6,870</b>       | <b>6,836</b> |
| <b>Tax payables</b>  | <b>512</b>         | <b>829</b>   |
| <b>Miscellaneous payables and other current liabilities:</b> |                    |              |
| • Amounts due for short-term employee benefits               | 760                | 712          |

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|   |                      |                      |
|---|----------------------|----------------------|
| • Amounts due to social security authorities  | 372                  | 375                  |
| • Short-term trade and miscellaneous deferred income  | 810                  | 821                  |
| • Advances received   | 45                   | 64                   |
| • Customer-related items  | 1,579                | 1,465                |
| • Amounts due for the TLC operating fee   | 29                   | 39                   |
| • Dividends approved, but yet to be paid to shareholders  | 25                   | 22                   |
| • Other current liabilities   | 305                  | 306                  |
| • Employee-related reserves (except for Employee severance indemnities) expected to be settled within 12 months | 70                   | 143                  |
| • Other reserves for risks and future charges, expected to be settled within 12 months                          | 1,356                | 772                  |
|   | <u>5,351</u>         | <u>4,719</u>         |
| <b>Total</b>  | <b><u>12,733</u></b> | <b><u>12,384</u></b> |

**Trade payables** (all due within 12 months) relate to Telecom Italia ( 2,185 million), Tim Italia ( 2,354 million) and foreign mobile telephone companies ( 1,242 million).

**Tax payables**, which include current tax payables of 227 million ( 48 million at December 31, 2004) and other tax payables of 602 million ( 464 million at December 31, 2004), increased by 317 million mainly for higher VAT payables, for IRAP payables and for the substitute tax due to the adjustment of the tax and accounting bases as allowed under Law No. 266/2005, mainly attributable to Tim Italia.

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Amounts due to social security authorities include the short-term portion of the amount payable to INPS under Law No. 58 for 213 million ( 217 million at December 31, 2004) as described in Note 21 Miscellaneous payables and other non-current liabilities .

Deferred income includes 282 million ( 351 million at December 31, 2004) for the deferral of revenues from the activation of Telecom Italia telephone service (current portion) and 38 million ( 55 million) for the deferral of revenues from recharging Tim Italia prepaid telephone cards.

**NOTE 23 FINANCIAL INSTRUMENTS****FAIR VALUE**

The majority of non-current financial liabilities of the Telecom Italia Group consist of notes and bonds and their measurement at fair value can be easily determined using financial instruments which, because of their size and distribution among investors, are frequently traded on the markets (see Note 18 Financial liabilities (current and non-current) ). Where public trading data is not available, for other types of loans, the following assumptions were made:

- the floating-rate loans were considered at the notional repayment amount;
- the fixed-rate loans were measured at fair value (present value of future flows using December 31, 2005 market rates).

Finally, the carrying value of most of the financial assets reasonably approximates their fair value as they are short term liquid financial investments.

Fair values (including interest accruals) of financial liabilities and assets at December 31, 2005 are set below:

| <b>Financial liabilities</b>             | <b>As of December 31, 2005</b> |  |
|--|--------------------------------|--|
|  | <b>Carrying values (IFRS)</b>  | <b>Market values (including interest accruals)</b> |
|  | <b>(millions of Euro)</b>      |  |
| Notes and bonds                          | 35,462                         | 37,427   |
| Convertible/exchangeable notes and bonds | 2,519                          | 2,680  |



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|   |               |               |
|---|---------------|---------------|
| Term loans  | 7,535         | 7,574         |
| Loans, other debt, finance lease liabilities        | 6,442         | 6,509         |
|   | <u>51,958</u> | <u>54,190</u> |
| <b>Discontinued operations/assets held for sale</b> | <b>143</b>    | <b>143</b>    |
|   | <u>52,101</u> | <u>54,333</u> |
| <b>Total Gross Financial Debt</b>                   | <b>52,101</b> | <b>54,333</b> |

| <u>Financial assets</u>   | As of December 31, 2005 |   |
|---|-------------------------|---|
|   | Carrying values (IFRS)  | Market values (including interest accruals) |
|   | (millions of Euro)      |   |
| Deposits, cash  | 9,958                   | 9,958                                       |
| Euro Commercial Papers  | 327                     | 327   |
| Deposits for temporary investments originally due beyond 3 months | 90                      | 90  |
| Securities  | 390                     | 390   |
| Other receivables   | 1,441                   | 1,441                                       |
|   | <u>12,206</u>           | <u>12,206</u>                               |
| <b>Discontinued operations/assets held for sale</b>               | <b>37</b>               | <b>37</b>                                   |
|   | <u>12,243</u>           | <u>12,243</u>                               |
| <b>Total Financial Assets</b>                                     | <b>12,243</b>           | <b>12,243</b>                               |

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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 predetermined operational limits.

Derivative financial instruments at December 31, 2005 are principally used by the Group to manage 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 at another date.

The following tables show the derivative transactions put into place by the Telecom Italia Group at December 31, 2005 divided between Fair Value Hedge instruments (Table 1), Cash Flow Hedge instruments (Table 2) and Non-Hedge Accounting instruments (Table 3) under IAS 39:

**Table 1 Fair Value Hedge Derivatives**

| <u>Description</u>   | <u>Equivalent<br/>notional<br/>amount</u> | <u>Mark to<br/>market<br/>(Clean<br/>Price)</u> |
|--|---|---|
|  | (millions of Euro)                        |   |
| CCIRS transactions finalized by Telecom Italia S.p.A. maturing April 2007 linked to EIB loan in U.S.\$180 million ( 153 million at the /U.S.\$ exchange rate at December 31, 2005)   | 150                                       | 2   |
| CCIRS transactions finalized by Telecom Italia S.p.A. maturing June 2007 on Telecom Italia S.p.A. notes amounting to GBP 850 million ( 1,240 million at the /pounds sterling exchange rate at December 31, 2005) issued on June 2004 | 1,289                                     | (31)  |
| CCIRS transactions finalized by Telecom Italia S.p.A. maturing November 2008 on the five years tranche of U.S.\$1,000 million ( 848 million at the /U.S.\$ exchange rate at December 31, 2005) on the                                | 850                                       | (32)  |

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notes issued in October 2003 by Telecom Italia Capital S.A. for a total amount of U.S.\$4,000 million

|   |              |             |
|---|--------------|-------------|
| CCIRS transactions effected by Telecom Italia S.p.A. maturing May 2032 on Telecom Italia Finance S.A. bonds amounting to Japanese yen 20 billion ( 144 million at the /Japanese yen exchange rate at December 31, 2005) originally issued by Olivetti Finance N.V.S.A. (2002-2032)  | 171          | (65)        |
| CCIRS transactions finalized by Telecom Italia Capital S.A. on the bonds issued by Telecom Italia Capital S.A. in October 2004 for a total amount of U.S.\$3,500 million ( 2,968 million at the /U.S.\$ exchange rate at December 31, 2005), including five-years tranche for U.S.\$1,250 million, ten-years tranche for U.S.\$1,250 million and thirty-years tranche for U.S.\$1,000 million | 2,831        | 45          |
| CCIRS transactions finalized by Telecom Italia Capital S.A. on the bonds issued by Telecom Italia Capital S.A. in September 2005 for a total amount of U.S.\$2,500 million ( 2,119 million at the /U.S.\$ exchange rate at December 31, 2005), including five-years tranche for U.S.\$700 million, and 5.33 years tranche for U.S.\$400 million and ten-years tranche for U.S.\$1,400 million | 2,068        | 19          |
| <b>Total Fair Value Hedge Derivatives</b>   | <b>7,359</b> | <b>(62)</b> |

- On the EIB loan in U.S.\$180 million, maturing April 2007, Telecom Italia S.p.A. entered into a CCIRS contract for **150 million** converting a 3-month Libor in U.S. dollars to the 3-month Euribor.

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- On the notes of GBP 850 million issued by Telecom Italia S.p.A. in June 2004, Telecom Italia S.p.A. put in place CCIRS contracts for **1,289 million** maturing June 2007, converting the GBP annual fixed rate of 6.375% to the Euribor.
- On the tranche maturing in November 2008 for U.S.\$1,000 million ( **850 million**) relating to the notes issued in October 2003 by Telecom Italia Capital S.A. for a total amount of U.S.\$4,000 million, Telecom Italia S.p.A. put in place CCIRS contracts converting the fixed rate coupon of 4% in U.S.\$ to the 3-month Euribor.
- For **171 million**, on the bonds 2002/2032 of JPY 20 billion with a 3.55% fixed rate coupon maturing May 2032, originally issued by Olivetti Finance N.V.S.A., the following transactions were put in place:
  - by Telecom Italia Finance S.A., an IRS contract in which Telecom Italia Finance S.A. receives the semiannual coupon of 3.55% in JPY and pays a semiannual floating rate in JPY;
  - by Telecom Italia S.p.A., a CCIRS contract, on a floating rate intragroup loan in JPY, in which Telecom Italia S.p.A. receives 6-month Libor in JPY and pays 6-month Euribor.
- On the bonds of U.S.\$3,500 million issued by Telecom Italia Capital S.A. in October 2004, Telecom Italia Capital S.A. put in place CCIRS contracts for **2,831 million** converting the fixed rate coupon in U.S. dollars to 6-month Euribor.
- On the notes of U.S.\$2,500 million issued by Telecom Italia Capital S.A. in September 2005, Telecom Italia Capital S.A. put in place CCIRS contracts for **2,068 million** converting the fixed rate coupon in U.S. dollars to 6-month Euribor.

**Tab. 2 Cash Flow Hedge Derivatives**

| Description  | Equivalent<br>notional<br>amount | Mark to<br>Market<br>(Clean<br>Price) |
|--|----------------------------------|---------------------------------------|
|  | (millions of Euro)               |                                       |
| IRS transactions effected by Telecom Italia Finance S.A. maturing January 2006 on Telecom Italia Finance S.A. notes with an original notional amount of 1,100 million, originally issued by Olivetti Finance N.V.S.A. (2002-2006)                          | 1,045                            |                                       |
| IRS transactions effected by Telecom Italia S.p.A. maturing March 2009 on notes of 110 million issued by Telecom Italia S.p.A. (2004-2009)   | 110                              | 1                                     |
| IRS transactions effected by Telecom Italia S.p.A. maturing January 2010 on five-years tranche C relating to Term Loan for a total amount of 12,000 million finalized on December 2004 in connection to Cash Tender Offer by Telecom Italia for TIM shares | 3,000                            | 12                                    |
| CCIRS transactions finalized by Telecom Italia S.p.A. maturing November 2013 on ten-years tranche for a total amount of U.S.\$2,000 million ( 1,694 million at the /U.S.\$ exchange rate at December 31,   | 1,709                            | (168)                                 |

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|   |              |              |
|---|--------------|--------------|
| 2005) on the notes issued by Telecom Italia Capital S.A. in October 2003 for a total amount of U.S.\$4,000 million  |              |              |
| IRS transactions effected by Telecom Italia S.p.A. maturing November 2015 on bonds of 120 million issued by Telecom Italia S.p.A. (2004-2015)   | 120          |              |
| CCIRS transactions finalized by Telecom Italia S.p.A. maturing December 2015 on bonds in the principal amount of GBP 500 million ( 730 million at the /pounds sterling rate at December 31, 2005) issued by Telecom Italia S.p.A. in June 2005  | 751          | (7)          |
| CCIRS transactions finalized by Telecom Italia S.p.A. maturing October 2029 related to the Dual-Currency loan with a notional principal of Japanese yen 20 billion ( 144 million at the /Japanese yen rate at December 31, 2005) originally received by Olivetti International Finance N.V. and now held by Telecom Italia Finance S.A. | 174          | (70)         |
| CCIRS transactions finalized by Telecom Italia S.p.A. maturing November 2033 on thirty-years tranche for a total amount of U.S.\$1,000 million ( 848 million at the /U.S.\$ exchange rate at December 31, 2005) on the bonds issued by Telecom Italia Capital S.A. in October 2003 for a total amount of U.S.\$4,000 million            | 849          | (160)        |
| <b>Total Cash Flow Hedge Derivatives</b>  | <b>7,758</b> | <b>(392)</b> |

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- On the notes 2002/2006 of 1,100 million at the quarterly floating rate issued by Telecom Italia Finance S.A. maturing January 2006, Telecom Italia Finance S.A. put in place:
  - IRS contracts for **855 million** in which Telecom Italia Finance S.A. receives a quarterly floating rate and pays a 2.68% fixed rate;
  - an IRS contract for **190 million** in which Telecom Italia Finance S.A. receives a quarterly floating rate +1.25% and pays a 3.83% fixed rate.
- On the notes 2004/2009 of **110 million** at a quarterly floating rate issued by Telecom Italia S.p.A. maturing March 2009, Telecom Italia S.p.A. put in place an IRS contract converting the 3-month Euribor to an annual fixed rate of 3.35%.
- In reference to the term loan for a total amount of 12,000 million finalized on December 2004 in connection with the cash tender offer for TIM S.p.A., Telecom Italia S.p.A. put in place IRS contracts for a total amount of **3,000 million** converting the 6-month Euribor on tranche C to an annual fixed rate of 3.088%, maturing January 2010.
- On the tranche maturing in November 2013 for U.S.\$2,000 million ( **1,709 million**) relating to the bonds issued in October 2003 by Telecom Italia Capital S.A. for a total amount of U.S.\$4,000 million, Telecom Italia S.p.A. put in place CCIRS contracts converting the coupon rate of 5.25% in U.S.\$ to a fixed rate of 5.035% in euro.
- On the bonds 2004/2015 of **120 million** at a quarterly floating rate issued by Telecom Italia S.p.A. maturing November 2015, Telecom Italia S.p.A. put in place IRS contracts converting the 3-month Euribor to an annual fixed rate of 4.161%.
- On the bonds 2005/2015 of GBP 500 million ( **751 million**) issued by Telecom Italia S.p.A. in June 2005, Telecom Italia S.p.A. put in place CCIRS contracts converting a fixed rate of 5.625% in GBP to a fixed rate of 4.34% in euro.
- For **174 million**, with reference to the Dual Currency loan with a notional principal of JPY 20 billion and a 5% fixed interest rate with a step-up of +0.45% in U.S. dollars maturing October 2029, originally received by Olivetti International Finance N.V., now carried by Telecom Italia Finance S.A., equivalent to 144 million at December 31, 2005, the following was put in place:
  - by Telecom Italia Finance S.A., an IRS contract converting the 5% fixed rate in U.S. dollars to the 6-month Libor in JPY;
  - by Telecom Italia S.p.A., a CCIRS contract in which Telecom Italia S.p.A., with regard to the intragroup loan in JPY, receives 6-month Libor in JPY and pays 6-month Euribor;
  - by Telecom Italia S.p.A. an IRS contract converting the semiannual floating rate in Euro to a 6.94% fixed rate up to maturity.
- On the tranche of U.S.\$1,000 million ( **849 million**) maturing in November 2033 relating to the bonds issued in October 2003 by Telecom Italia Capital S.A. for a total amount of U.S.\$4,000 million, Telecom Italia S.p.A. put in place CCIRS

contracts converting the fixed rate of 6.375% in U.S. dollars to the fixed rate of 6% in Euro.

The selected method to test the effectiveness, retrospectively and prospectively, of Fair Value Hedge instruments and Cash Flow Hedge instruments is the Volatility Risk Reduction (VRR) Test. This test assesses the ratio between the portfolio risk (where the portfolio means the hedging instrument and the item hedged) and the risk of the hedged item taken separately. In short, the portfolio risk must be less than the risk of the item hedged:

$VRR = 1$  (portfolio risk / risk of the hedged item).

The better the hedging ratio, the more VRR tends to the value 1. To establish if a hedge is effective, this ratio must be higher than the threshold over which the test identifies the hedging as highly effective as required by IFRS.

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| Description  | Equivalent<br>notional<br>amount | Mark to<br>Market<br>(Clean<br>Price) |
|--|----------------------------------|---------------------------------------|
|  | (millions of Euro)               |                                       |
| Floating to floating IRS transactions finalized by Telecom Italia S.p.A.   | 41                               |                                       |
| IRS transactions effected by Telecom Italia Finance S.A. maturing January 2006 on Telecom Italia Finance S.A. notes with an original notional amount of 1,100 million, originally issued by Olivetti Finance N.V.S.A. (2002-2006)        | 55                               |                                       |
| IRS transactions maturing February 2009 by Telecom Italia Finance S.A. on notes of 1,500 million carried by Telecom Italia Finance S.A., originally issued by Olivetti International N.V. (1999-2009)                                    | 500                              | (6)                                   |
| IRS transactions effected by Telecom Italia Finance S.A. maturing July 2009 on Telecom Italia Finance S.A. notes with an original notional amount of 2,350 million, originally issued by Olivetti International Finance N.V. (1999-2009) | 850                              | (7)                                   |
| IRS transactions effected by Telecom Italia Finance S.A. maturing April 2011 on Telecom Italia Finance S.A. notes of 2,000 million, originally issued by Sogerim S.A. (2001-2011)  | 350                              | 6                                     |
| IRS and CCIRS contracts finalized by Telecom Italia Finance S.A. on financial assets   | 186                              | (7)                                   |
| Interest rate and forward foreign exchange contracts finalized by Group companies  | 517                              | (5)                                   |
| <b>Total Non Hedge Accounting Derivatives</b>  | <b>2,499</b>                     | <b>(19)</b>                           |

- The floating to floating IRS transactions put in place by Telecom Italia S.p.A. for a notional amount of **41 million** refer to indexed loans at domestic parameters (Rendint, Rolint, Robot) with conversion to the 6-month Euribor.
- On notes 2002-2006 with an original notional amount of 1,100 million at a quarterly floating rate, issued by Telecom Italia Finance S.A., maturing January 2006, Telecom Italia Finance S.A. put in place:

IRS contracts for **45 million** in which Telecom Italia Finance S.A. receives a quarterly floating rate and pays a fixed rate of 2.68%;

an IRS contract for **10 million** in which Telecom Italia Finance S.A. receives a quarterly floating rate +1.25% and pays a fixed rate of 3.83%.

- On the notes 1999/2009 of 1,500 million at a 5.15% fixed rate maturing February 2009, carried by Telecom Italia Finance S.A., originally issued by Olivetti International N.V., Telecom Italia Finance S.A. put in place an IRS contract for **500**



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**million** in which Telecom Italia Finance S.A. receives a 6-month Euribor and pays a fixed rate of 4.06%. Moreover, in the last two years, Telecom Italia Finance S.A. will receive these amounts if the 5-year swap rate in Euro remains higher than the 1-year swap rate in Euro.

- On the notes 1999/2009 with an original notional amount of 2,350 million at an annual 6.125% fixed rate with a step-up of +0.45%, carried by Telecom Italia Finance S.A. (originally issued by Olivetti International Finance N.V.), maturing July 2009, Telecom Italia Finance S.A. put in place, with the same maturity dates, the following IRS transactions totaling **850 million**:

an IRS contract for 500 million in which Telecom Italia Finance S.A. receives a semiannual floating rate in euro and pays a semiannual floating rate in euro set in arrears with the following additional transactions:

- a) purchase of a cap at 4.50%;
- b) sale of a cap at 5.50%.

Moreover, in the last two years, Telecom Italia Finance S.A. will receive these amounts if the 5-year swap rate in euro remains higher than the 1-year swap rate in euro;

sale of a floor for a notional amount of 350 million at the 6-month Libor in U.S. dollars with interest in arrears decreasing from 3.80% to 3.15%.

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- On the notes 2001/2011 of 2,000 million at an annual 7% fixed rate issued by Telecom Italia Finance S.A. maturing April 2011, Telecom Italia Finance S.A. put in place IRS contracts for 350 million converting the annual fixed rate of 7% to a quarterly rate in SEK and with the additional following transactions:
  - a) purchase of a cap at a 3.65% annual rate;
  - b) sale of a floor with the exercise rate from 1.75% to 3.20%.
- Derivative financial instruments on financial assets for a total amount of **186 million** were put in place by Telecom Italia Finance S.A. by IRS contracts for 125 million converting a fixed rate of 6.035% to a floating rate in Euro and CCIRS contracts for 61 million converting the 6-month Libor in U.S. dollars to the 6-month Euribor.
- Interest rate and foreign exchange transactions for a total amount of **517 million** are composed of:
  - foreign exchange transactions carried by Telecom Italia S.p.A. for 40 million;
  - foreign exchange transactions carried by Telecom Italia Finance S.A. for 350 million;
  - foreign exchange transactions carried by Telecom Italia Capital S.A. for 1 million;
  - foreign exchange transactions carried by Olivetti S.p.A. for 12 million;
  - foreign exchange transactions carried by Tim Italia S.p.A. for 10 million;
  - foreign exchange transactions carried by TI Sparkle S.p.A. for 15 million;
  - interest rate and foreign exchange transactions carried by Maxitel S.A. for 50 million;
  - foreign exchange transactions carried by TIM Celular S.A. for 1 million;
  - interest rate and foreign exchange transactions carried by TIM Participações S.A. for 38 million.

The following table shows the derivative financial instruments of the Telecom Italia Group by type:

| <u>Type</u> | <u>Hedged risk</u> | <u>Notional amount</u> | <u>Mark to Market Spot (Clean Price) as of</u> | <u>Mark to Market Spot (Clean Price) as of</u> |
|-------------|--------------------|------------------------|--|--|
|-------------|--------------------|------------------------|--|--|

|   |  | December 31,<br>2005 | December 31,<br>2004 |
|---|--|----------------------|----------------------|
|   |  | (millions of Euro)   |                      |
| Interest Rate Swaps                           | Interest Rate Risk   |                      | 52                   |
| Cross Currency and Interest Rate Swaps        | Interest Rate Risk and Foreign Currency Exchange Rate Risk | 7,359                | (62)                 |
|   |  | (605)                | (605)                |
| <b>Total Fair Value Hedge Derivatives</b>     |  | <b>7,359</b>         | <b>(62)</b>          |
|   |  | <b>(553)</b>         | <b>(553)</b>         |
| 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)                |
|   |  | (660)                | (660)                |
| <b>Total Cash Flow Hedge Derivatives</b>      |  | <b>7,758</b>         | <b>(392)</b>         |
|   |  | <b>(666)</b>         | <b>(666)</b>         |
| <b>Non-Hedge Accounting Derivatives</b>       |  | <b>2,499</b>         | <b>(19)</b>          |
|   |  | <b>5(*)</b>          | <b>5(*)</b>          |
| <b>Total Telecom Italia Group Derivatives</b> |  | <b>17,616</b>        | <b>(473)</b>         |
|   |  | <b>(1,214)</b>       | <b>(1,214)</b>       |

(\*) Based on the same scope of consolidation the amount would have been 32 million.

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The following table shows, for Cash Flow Hedge Derivatives, the amount recognized in the Reserve for fair value adjustments of hedging instruments during 2005 and the portion reversed from the reserve to the statement of operations as an exchange rate adjustment, before the relative tax effect:

| Description                        | Reserve for fair value adjustments of Cash Flow Hedge Derivatives at December 31, 2005 | Reserve for fair value adjustments of Cash Flow Hedge Derivatives at December 31, 2004 | Mark to Market change recognized in the Reserve for fair value adjustments of hedging derivatives | Amount reversed from the Reserve for fair value adjustments of hedging derivatives to the statement of operations as an exchange rate adjustment | Impact of Cash Flow Hedge Derivatives in 2005 on the Reserve for fair value adjustments of hedging derivatives |
|------------------------------------|--|--|---|--|--|
|                                    |  |  | (millions of Euro)  |  |  |
| <b>Cash Flow Hedge Derivatives</b> | <b>(311)</b>   | <b>(265)</b>   | <b>274</b>  | <b>(320)</b>   | <b>(46)</b>  |

**NOTE 24 FINANCIAL ASSETS PLEDGED AS COLLATERAL FOR FINANCIAL LIABILITIES**

- 2,923,168 Corporacion Digital shares, owned by TIM International, as well as tangible and intangible assets of the subsidiary Corporacion Digital are pledged as collateral for the loan granted in 2002 by a syndicate of banks in the form of Project Financing, for an amount of 122 million at December 31, 2005.
- The contracts for easy-term loans granted by the Brazilian development bank BNDES (Banco Nacional de Desenvolvimento Economico e Social) to certain operating companies of the TIM Brasil group (Maxitel, TIM Celular and TIM Sul) for a total amount of 326 million are guaranteed by a part of the receipts of those companies which pass through bank accounts that are pledged in favor of BNDES. The bank will have access to such amounts only in the case of default by the company, otherwise the funds will be automatically transferred to accounts on which the company has full access.

**NOTE 25 COMMITMENTS AND POTENTIAL LIABILITIES****a) Disputes, Litigations and Legal Proceedings Pending**

The main legal and arbitration proceedings in which companies of the Telecom Italia Group were involved as of December 31, 2005 are described below. Except where explicitly mentioned, provisions have not been made, as there is not an adequate objective basis for doing so or because a negative outcome of the dispute is considered unlikely.

**TELE2**

Tele2 brought an action before the Milan Court of Appeal in June 2005 against Telecom Italia for alleged abuse of dominant position in the markets for fixed voice telephony access and services, related to Telecom Italia's "Hello gratis" offer to all users, including customers of other operators, featuring 90 minutes of calling time completely free of charge (up to 60 minutes of local calls and 30 minutes of long-distance calls every two months). Tele2 claimed damages of more than 100 million, asserting that the indiscriminate application of the traffic bonus had the effect of taking traffic away from competitors, as customers were induced to make use of the bonus regardless of their possible contracts with other operators. In addition, the offer supposedly prevents comparative advertising by not allowing a direct, homogeneous comparison of telephone charges per minute.

\* \* \*

On October 10, 2005 Telecom Italia filed an appeal from the order issued on September 28, 2005 by the Milan Court of Appeal granting Tele2's request for a preliminary injunction restraining Telecom Italia from continuing to impose offers, in the supply of the metered wholesale ADSL service, with obligatory payment of at least 5 hours of traffic per month included in the monthly subscription fee of 6.30 plus VAT. Disregarding the fact that Telecom Italia's offers had been submitted to the Communications Authority in advance, the court found that the contractual conditions did not allow Tele2 to participate in the market for ADSL broadband services on an equal competitive footing.

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On December 22, 2005 the court upheld Telecom Italia's appeal and revoked its September 2005 order enjoining Telecom Italia from continuing the E@asy.IP metered ADSL offer inclusive of a guaranteed minimum of 5 hours of traffic.

Meanwhile, on October 28, 2005 Tele2 had initiated proceedings on the merits of the case, claiming damages of more than 15 million for additional costs incurred, loss of revenue and customers and injury to its business image and reputation.

\* \* \*

In July 2005 Tele2 notified Telecom Italia that it had filed another urgent petition to ascertain an alleged abuse of dominant position in the market for ADSL broadband data access, with reference to the ADSL wholesale flat-rate single access contract between the parties. The illegitimate conduct of Telecom Italia allegedly consisted of activating the service for Tele2 customers who had not requested it, in order to prevent Tele2 from providing its own ADSL services, and in delaying the deactivation of these not-requested provided services.

In November 2005 the Milan Court of Appeal, partially granting the petition, ordered Telecom Italia to activate the ADSL services of Tele2 customers within the contractual time limit of 42 days from the date of Tele2's requests, apart from the cases where customers were in fact already being provided such services or had terminated them.

Telecom Italia has decided not to oppose the preliminary order, which basically calls for fulfilling the contract between the parties and therefore is unlikely to imply particular adverse effects.

On December 12, 2005 Tele2 notified Telecom Italia to appear before the Milan Court of Appeal for the proceeding on the merits of the case.

\* \* \*

On November 22, 2005 the Milan Court of Appeal issued an order dismissing Tele2's urgent petition for a preliminary injunction restraining Telecom Italia from continuing the Alice Free offer of retail metered ADSL, which Telecom Italia had recently promoted on its website and which gave new customers subscribing to the offer by November 30, 2005 the possibility to navigate free of charge until December 31, 2005 without having to pay either the one-time-only fee or the activation fee.

Tele2 had asserted that the economic terms of the offer constituted an abuse of dominant position by Telecom Italia in the domestic market for broadband data access services and, in particular, a violation of the principle of equal treatment inasmuch as the retail offer had not been preceded by an adjustment of the corresponding wholesale offers that would have permitted the other

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OLOs to replicate these terms with their own customers. In this regard, the Court of Appeal determined, inter alia, that price competition was normal at the level of retail offers and thus constituted permissible conduct, on a general basis, for the dominant operator to engage in with a view to protecting its own business interests.

In December 2005 Tele2 appealed the decision of the Milan Court of Appeal.

\* \* \*

Telecom Italia has brought an action before the Milan Court against Tele2 and its Swedish parent company Tele2 AB for acts of unfair competition in connection with the comparative advertising campaigns run by Tele2, requesting that the two companies be held jointly and severally liable for the payment of at least 200 million in damages.

Tele2 has filed a counterclaim asserting that Telecom Italia's conduct, and specifically the application of the traffic bonus in the "Hello gratis" offer, constitutes a tort. Basically, Tele2 has put forward the same arguments as in the action brought before the Milan Court of Appeal challenging the legitimacy of the "Hello gratis" offer, reported above, and has claimed the same damages as in the pending case (more than 100 million).

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**EUTELIA**

In September 2005 Eutelia, a telecommunications operator, notified Telecom Italia that it had filed an urgent petition with the Milan Court of Appeal regarding allegedly abusive conduct in the market for broadband data access services.

The alleged abuse consists in the activation of ADSL service for customers who had not requested it, with a view to preventing Eutelia from providing its own ADSL services, and in delayed deactivation of these not-requested provided services.

In addition, Eutelia objects that Telecom Italia, in violation of the regulations in force, makes activation of ADSL services contingent on the customer being a subscriber to the Company's telephony service and terminates the ADSL links of customers who decide to withdraw from the basic telephony contract.

With an order issued on November 3, 2005, the Milan Court of Appeal partially granted Eutelia's petition, temporarily enjoining Telecom Italia from deactivating the retail ADSL service for Eutelia customers who withdraw from the telephony contract signed with Telecom Italia.

Telecom Italia decided not to oppose the preliminary injunction.

In December 2005 Eutelia initiated the proceeding on the merits of the case before the Milan Court of Appeal, claiming damages of around 40 million.

**VODAFONE**

On November 2, 2005, Vodafone made an extra-judicial request for the restitution of more than 16 million in alleged overpayments to Telecom Italia for interconnection services supplied between January 1, and July 24, 1998. The question originated from the petition with which Omnitel (now Vodafone) challenged the part of Communications Authority Resolution 1/CIR/98 (Approval of Telecom Italia's Reference Interconnection Offer) establishing that, pursuant to a ministerial decree issued on April 23, 1998, the new economic conditions for interconnections would become effective for the existing GSM license-holders (TIM and Omnitel) from July 25, 1998 (the date Telecom Italia's Reference Offer was submitted) rather than retroactively from January 1, as envisaged for the fixed-network operators.

The State Council annulled the Communication Authority's measure, reinstating the administrative court's ruling on the matter.



Telecom Italia has appealed the State Council's decision to the Court of Cassation on the grounds that the State Council (i) substituted its own evaluation for that of the Ministry by laying down a retroactive rule that neither the Ministry nor the Authority would have been able to adopt; and (ii) rendered ineffective Article 15 of the above-mentioned ministerial decree of April 23, 1998, which Vodafone had not challenged in its original petition.

## **IL NUMERO ITALIA**

In August 2005, Il Numero Italia S.r.l. and its subsidiary Directory Assistance Company S.r.l. filed an urgent petition with the Milan Court against Telecom Italia, alleging illicit conduct for non-compliance with the regulations on subscriber directory information services. The Court granted the petition, ordering Telecom Italia to cease making all references via the Company's 12 and 412 information services (terminated on October 1, and December 1, 2005, respectively) to the new numbering of subscriber information services, and rejected Telecom Italia's subsequent appeal against this order.

In September 2005 Il Numero Italia and Directory Assistance brought an action (subsequent to the preliminary order), claiming damages of 14.4 million for actual economic and reputational losses and of 60 million per year (to be multiplied by a suitable number of years, determined using the methods commonly applied in business economics to calculate the discounted value of economic activities in the sector of subscriber information services) for losses of anticipated profits.

\* \* \*

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A preliminary injunction *inaudita altera parte* on December 2, 2005 by the Milan Court on an urgent petition filed by Il Numero Srl and its subsidiary Directory Assistance Company Srl, ordered Telecom Italia immediately to cease making any direct or indirect reference, in whatever form or manner, through its 412 subscriber information service to its own numbers, including 1254 .

The above-mentioned petition followed a series of similar actions brought by Numero Italia against Telecom Italia, in which the plaintiff alleges that Telecom Italia has engaged in unfair practices and abuse of its dominant position such as to prevent access on equal terms to the market for subscriber information services, in violation of the regulations in force.

Although Telecom Italia had meanwhile taken every necessary operational step to comply with the regulatory prescriptions, on December 12, 2005, Il Numero Italia and its subsidiary petitioned the Milan Court to adopt appropriate measure to ensure effective compliance by Telecom Italian with the above-mentioned order of December 2, 2005.

With an order issued on December 22, 2005 the Milan Court confirmed *inaudita altera parte* decree of December 2, 2005, again ordering Telecom Italia immediately to cease making any direct or indirect reference to any of its subscriber directory information numbers by means of the 412 access service or rerouting from that service to another of its operating numbers. The court also ordered Telecom Italia to publish the order in two national daily newspapers. On January 2, 2006 Il Numero Italia S.r.l. and its subsidiary Directory Assistance Company S.r.l. brought an action to ascertain the violation by Telecom Italia of the regulations in force concerning subscriber information services and for damages, to be quantified during the proceeding, for alleged losses.

**CECCHI GORI**

In relation to the complex legal dispute initiated by the Cecchi Gori group against Seat (now Telecom Italia Media) and, in particular, the action related to the resolutions adopted on April 27, 2001 by the shareholders meetings of Cecchi Gori Communications (now HMC) approving the annual report and financial statements for the year ended December 31, 2000 and canceling and then reconstituting the company's share capital, on November 24, 2005 the Rome Court of Appeal dismissed the Cecchi Gori group's appeal against the ruling of the Rome Court of first instance to reject the petition for annulment of the resolutions.

The following cases remain pending in the ordinary courts:

- an appeal brought before the Rome Court of Appeal by the Cecchi Gori group against the ruling that rejected the petition for annulment of the resolutions approved on August 11, 2000 by the extraordinary shareholders meeting of Cecchi Gori Communications (now Holding Media Communications) to amend certain company's bylaws;
- an action brought before the Milan Court by the Cecchi Gori group for damages for a tort resulting in injury from the conduct of Seat and of the directors it designated to the board of Cecchi Gori Communications with the alleged aim of ousting the majority shareholder, Cecchi Gori Media Holding;

- an appeal brought before the Milan Court of Appeal by the Cecchi Gori group against the ruling issued by the court of first instance rejecting the petition for annulment or cancellation of the deed under which the Cecchi Gori Communications shares belonging to Cecchi Gori Media Holding were pledged as security.

## **NHAI**

In September 2005, Nhai Srl (formerly Help S.p.A.) brought an action before the Rome Civil Court to establish that in the first half of the 1990s Telesoft (subsequently merged into Telecom Italia), in its capacity as member of the Consortium for Automatic Telephone Traffic Data Collection and Processing (whose participants included the petitioner and Telesoft) had competed with the consortium, in violation of the obligations provided for in the consortium's agreements and by-laws. Nhai consequently asked that Telecom be ordered to pay damages of between 16 million and 25 million for the losses incurred by the consortium and by Help, for its share, in connection with the orders not received.

Nhai also alleged that Telesoft, during the life of the consortium, had appropriated software developed by Help, in violation of the agreements between the members of the consortium, and for this claimed damages of 1 million.

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**INTERMINISTERIAL DECREE OF FEBRUARY 22, 2005**

In July 2005, H3G notified Telecom Italia, as an adversarial party, that it had filed an extraordinary petition to the President of the Republic against the Ministry of Communications and the Ministry for the Economy and Finance for the annulment, following suspension, of the interministerial decree of February 22, 2005 concerning the procedures and criteria for establishing grants for the purchase of broadband Internet data transmission/reception equipment. H3G challenged the part of the decree that limited the government grants to holders of a subscription contract while failing to extend them to holders of prepaid cards. In August, Telecom Italia requested that the extraordinary petition be transferred to the Lazio Administrative Court, in order to obtain greater guarantees regarding the opportunity for all the parties to state their case and above all to have two levels of judgment. H3G filed as party in the resulting proceeding. In August H3G filed a second petition with the Lazio Administrative Court, this time for annulment of certain measures issued by the Ministry of Communications to implement the interministerial decree of February 22, 2005, requesting joint discussion of the two petitions on the grounds of related matter.

**LEVY PURSUANT TO ARTICLE 20.2 OF LAW NO. 448/1998**

The decisions with which the Lazio Administrative Court, granting the petitions submitted by Telecom Italia and TIM, annulled a decree issued by the Ministry of Communications on March 21, 2000 were published on January 4, 2005.

In their petitions Telecom Italia and TIM had challenged the compatibility of Article 20 of Law No. 448/1998 with EU Community law, in particular with the principle that no capital charges may be imposed on telecommunications companies over and above those provided for in EU Community law (examination expenses, use of so-called scarce resources and financing of the universal service). Telecom Italia and TIM had also demanded restitution of the amounts paid but not due in respect of the 1999 financial year, when, in connection with the initial application of the subsequently annulled decree, the first annual installment of the new levy was paid in a total amount of more than 500 million. (Subsequently, considering the petitions pending, Telecom Italia and TIM did not make payments, setting aside the contested amounts in a reserve). With the annulment of the decree, the State is obliged to make restitution of the amounts in question.

In November 2005 a notice was sent to the Minister for the Economy and Finance and the Minister of Communications demanding restitution of 362 million paid by Telecom Italia and 185 million paid by TIM, plus interest and adjustment for inflation. Meanwhile, the time limit for appeal expired on February 19, 2006 and so the decisions by the Lazio Administrative Court granting the petitions of TIM and Telecom Italia have become final. However, in the absence of compliance by the ministries cited in the decisions of the Lazio Administrative Court (and in the Presidential Decree deciding on the extraordinary petition by Albacom and Infostrada), with due repayment of the obligation plus legal interest thereon, Telecom Italia (both on its own behalf and as universal successor to Tim Italia S.p.A. as a consequence of the merger effective from March 1, 2006) has petitioned the administrative courts to issue a compliance order for restitution by the State of the sums paid but not due.

Following the European Court of Justice's decision of September 18, 2003 on similar appeals by Albacom and Infostrada, which declared the levy to be incompatible with EU Community law, the Telecom Italia Group had already reversed 1,465 million of liabilities (payables and reserves for risks and charges) relating to the financial years 2000, 2001 and 2002.

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In the light of the above-mentioned ruling by the Lazio Administrative Court annulling the regulation on grounds of illegitimacy, 546 million, plus 74 million of interest paid by the Group in respect of the levy for the 1999 financial year, have been included in income.

\* \* \*

Petitions by Telecom Italia and TIM are still pending before the Lazio Administrative Court ascertain the right not to pay any amount as a license fee for 1998 and to obtain restitution of the 529 million already paid. The request is based on the illegitimacy of Article 21 of Presidential Decree No. 318/1998, which extended the effectiveness of the license fee even after Directive 97/13/EU came into force and the expiry of the time limit for its transposition into Italian law.

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In the light of the Court of Justice's above-mentioned decision of September 18, 2003, additional reasons based on the levy's incompatibility with Community law were submitted on February 9, 2004, to corroborate the arguments set forth in the main proceeding.

\* \* \*

Also pending is the petition by Telecom Italia to the Lazio Administrative Court for annulment of the note dated July 9, 2003 with which the Ministry of Communications challenged the non-inclusion of some items of income in the basis of assessment for the license fee for 1997 and 1998.

The difference deriving from the recalculation would amount to 31 million for 1997 and 41 million for 1998. The petition follows others the Company had already filed concerning the license fee computation method in connection with the gradual liberalization of the telecommunications sector. A provision of 64 million has been made for the amounts involved in these disputes.

Lastly, an appeal by TIM against the ministerial decisions on the verification of the license fee for the years 1995, 1996, 1997 and 1998 is pending before the Lazio Administrative Court. The contested amount of ( 14 million) has been accrued in a reserve.

**GALACTICA**

The action brought by the Internet Service Provider Galactica in May 2001 over the non-renewal of an agreement for testing a flat-rate Internet access service is still pending. Galactica asserted that the non-renewal was illegitimate and claimed damages, serving notice on Telecom Italia not to interrupt provision of the service. In February 2002 Galactica brought a second action against Telecom Italia, claiming damages for unfair trade practices.

The two proceedings were combined in May 2002. In October 2002 Servinternet S.p.A. (formerly Galactica S.p.A.) brought a third action against Telecom Italia before the Milan Court, seeking a judgment against Telecom Italia for tort. This proceeding has also been combined with the other two already pending before the same judge. The claims lodged by the plaintiff amount to around 90 million.

For its part Telecom Italia has filed a counterclaim for Galactica to be ordered to pay more than 5 million as consideration for the increase in traffic in the period January-July 2001.

**TELEQUE COMMUNICATIONS**

Also pending is the proceeding opened before the Rome Court of Appeal in November 2002 by Teleque Communications S.p.A., a company operating in the field of prepaid cards for international telephony services, which brought an action against Telecom Italia for unfair trade practices, claiming damages of 65 million. Teleque Communications S.p.A. asserted that Telecom Italia had gained a competitive advantage by imposing additional costs on Teleque Communications S.p.A for the supply of interconnection services that it did not charge to its own final customers in the field of prepaid international services. In the hearing of February 16, 2004 the trial was interrupted following the notification by Telecom Italia of the declaration of its cessation as a legal entity as a consequence of the merger of Telecom Italia into Olivetti S.p.A..

On October 19, 2004 the trustee in bankruptcy (Teleque Communications was declared bankrupt on December 17, 2003) revived the action.

#### **ASSOPROVIDER/TELECOM ITALIA AND AIP-MULTILINK/TELECOM ITALIA**

On December 5, 2005 Assoprovider an independent association of 190 Internet Service Providers (ISPs) notified Telecom Italian of the filing of an urgent petition with the Court of Milan pursuant to Article 700 of the Code of Civil Procedure in which it requested that the Teleonomy Internet retail offer of dial-up Internet access be suspended in the absence of an equivalent wholesale offer permitting competitors to replicate it. The plaintiff alleged that this situation obstructed the creation of networks and services by other ISPs, to the detriment of competition and consumers, and provoked an illicit diversion of customers that fell with the scope of the rules against unfair competition.

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In addition, on December 5, 2005 the Italian Association of Internet Providers and an Internet Service Provider named Multilink filed two separate urgent petitions with the Milan Court, identical in substance to that of Assoprovider, essentially seeking an order to prevent the marketing of the Teleconomy Internet offer.

The two proceedings were combined and the court issued an order against Telecom Italia, granting the petitions. Telecom Italia appealed and the court revoked the preliminary injunction, declaring that the subject of the petitions had ceased to exist.

**TISCALI ITALIA/TELECOM ITALIA**

On March 3, 2006, the Court rejected Telecom Italia's appeal against the ruling issued on November 22, 2005 by the Court of Rome which, in granting a petition filed by Tiscali S.r.l., ordered Telecom Italia to fulfill its obligations to Tiscali arising from the shared access contract concluded between the parties on July 27, 2004, supplemented by law and resolutions of the Communication Authority, permitting the immediate and automatic transfer of Telecom Italia customers who opted to change to Tiscali for the purchase of ADSL services.

The case originates in the shared access service supply contract concluded by Telecom and Tiscali on July 27, 2004. The contract calls for Tiscali to be supplied unbundled shared access to the connections of Telecom Italia's copper distribution network (with which Telecom Italia continues to supply final customers with the voice telephony service, while the Internet access service is provided by Tiscali). According to Tiscali, requests to activate the shared access service for numerous customers met with a refusal by Telecom Italia to free up the lines with which it provides Internet access services (marketed under the trademarks Alice and Tin.it) to final customers, so that Telecom Italia customers who opted to use Tiscali's Internet access service in place of those supplied by Telecom Italia were in fact unable to extricate themselves from Telecom Italia, which was therefore violating both its contractual obligations in respect of Tiscali and the rules laid down by the Communications Authority.

In December 2005 Tiscali brought an action against Telecom Italia before the Court of Rome subsequent to the ruling of November 22, 2005, on its preliminary petition. Following dismissal of the appeal from that ruling, the trial is continuing.

**TELECOM ITALIA ARBITRATION PROCEEDINGS WITH FASTWEB AND WIND (Inverse interconnection)**

On December 13, 2005, Telecom Italia began an arbitration proceeding with Fastweb S.p.A. to obtain a decision recognizing: (i) that Fastweb had breached the interconnection contract concluded on January 28, 2000 by unilaterally altering the economic conditions for termination on Fastweb's fixed network of traffic made to geographical numbers; (ii) that the value of termination on the Fastweb network be determined in accordance with the principle of reciprocity; and (iii) that Telecom Italia did not owe the larger sums requested by Fastweb applying its self-determined termination charges.

Fastweb's conduct stems from some resolutions issued by the Communications Authority in 2003 Resolution 11/03 CIR (approval of the Telecom Italia's reference offer for the year 2003) and Resolution 289/03 CONS (regulation and control of the maximum prices



of the voice telephony services supplied by Telecom Italia ) that permitted OLOs to apply differentiated charges for interconnection service and, in particular, for termination service. These resolutions were challenged at the time by Telecom Italia before the Lazio Administrative Court, which, rejected the petition, on January 27, 2006. Telecom Italia is preparing to appeal against the ruling by the Lazio Administrative Court to the State Council.

\* \* \*

On December 15, 2005 Telecom Italia initiated a similar proceeding with Wind under the arbitration clause of the inverse interconnection contract concluded with Wind on December 31, 1999, claiming the illegitimacy of Wind's conduct in unilaterally altering the economic conditions for termination on Wind's fixed network of traffic made to geographical calling codes.

Wind billed Telecom Italia for such services in accordance with the economic conditions established for the whole of 2003 by the above-mentioned interconnection contract for the termination of traffic on Wind's fixed network

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for traffic originated by Telecom Italia's fixed network. However, beginning in October 2003 Wind, like Fastweb, imposed a new, unilateral version of the agreed economic conditions on Telecom Italia.

**FASTWEB/TELECOM ITALIA**

On December 29, 2005, Fastweb filed an urgent petition with the Rome Court of Appeal to obtain preliminary measures against what the plaintiff alleged to be the exclusionary strategy adopted by Telecom Italia in the broadband market, in violation of antitrust rules and consisting in: the asymmetrical exploitation of information on final customers by Telecom Italia's marketing divisions; the creation of a system of incentives for the Telecom Italia sales network with a view to excluding Fastweb from the above-mentioned market; a massive campaign of soliciting Fastweb customers with a view to convincing them to withdraw from the contracts already signed with Fastweb, *inter alia* with the use of denigrating statements and personalized, discriminatory offers reserved to such customers. Telecom Italia contested the petition, arguing that Fastweb's accusations were unfounded and prejudicially objecting that the case did not fall within the jurisdiction of the Rome Court of Appeal. On February 24, 2006 the court sustained Telecom Italia's objection, declaring that the case did not fall within its jurisdiction but within that of the Milan Court of Appeal.

**UNIVERSAL SERVICE**

The regulations regarding universal service envisage a mechanism for sharing the net cost of the universal service in Italy among operators of public telecommunications networks, suppliers of voice telephony services accessible to the public and the providers of mobile and personal communication services, in the event that the obligations of providing the universal service constitute an unfair burden on the entity or entities appointed to provide it (Telecom Italia).

The following actions remain pending in the complex challenge by some operators against the Communications Authority's decision concerning the universal service net cost-sharing mechanism:

Universal service net cost for 1999:

- the petition by Vodafone to the Lazio Administrative Court for the annulment of: (i) the decision with which the Communications Authority, in renewing the proceeding for the application of the universal service net cost-sharing mechanism for 1999, recalculated the amount of Vodafone's contribution; and (ii) the note dated November 30, 2005 with which the Ministry of Communications enjoined Vodafone to pay the contribution for the financing of the universal service in the amount of 8.6 million, as determined by the Communications Authority in the above-mentioned decision;

Universal service net cost for 2000:

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- the petitions submitted respectively by Vodafone to the Lazio Administrative Court and by Wind to the Head of State for the annulment of the Communications Authority's decision governing the same cost-sharing mechanism for 2000. Vodafone has requested that the issue be referred as a preliminary matter to the European Court of Justice for a ruling on the correct interpretation of the Community directives;
- the petition by Vodafone to the Lazio Administrative Court for the annulment of the note dated April 29, 2003 with which the Ministry of Communications enjoined Vodafone to pay the contribution for the year 2000 for the financing of the universal service in the amount of approximately 11 million, as determined by the Communications Authority in the above-mentioned decision;

### Universal service net cost for 2001:

- the petition by Vodafone to the Lazio Administrative Court for the annulment of the Communications Authority's decision governing the cost-sharing mechanism for 2001. Despite the petition, Vodafone has paid its contribution to the fund for 2001, in the amount of 8.54 million;

### Universal service net cost for 2002:

- the petitions by Vodafone and Wind to the Lazio Administrative Court for the annulment of the Communications Authority's decision governing the cost-sharing mechanism for 2002;

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- the petition by Vodafone to the Lazio Administrative Court for the annulment and interim suspension of the note dated March 17, 2005 with which the Ministry for Communications requested Vodafone to pay approximately 8 million, determined by the Authority in the above-mentioned decision, as its contribution for the year 2002 to finance the universal service. In November 2002 the Lazio Administrative Court rejected Vodafone's request for preliminary suspension. Vodafone appealed this ruling to the State Council, which in January 2006 rejected Vodafone's appeal for a preliminary measure. In January 2006, the Ministry of Communications therefore enjoined Vodafone to pay its contribution to the financing of the universal service for the years 1999, 2000 and 2002.

**ALLEGED VIOLATIONS OF ANTITRUST LAW**

In December 2004 Telecom Italia lodged an appeal with the Lazio Administrative Court from the measure with which the Antitrust Authority, at the conclusion of Proceeding A351, had imposed a fine of 152 million on the Company for abuses of dominant position, requesting annulment of the measure and interim suspension of its effects. The court, in a decision published in May 2005 and appealed from by the Authority, largely upheld the pleadings of Telecom Italia, annulling the fine. Telecom Italia thereupon lodged a cross appeal from the part of the decision that did not accept some of the grounds of its objections to the measure. The proceeding is pending.

In February 2006 the State Council partly upheld the initial and cross appeals of the other applicants, rejecting Telecom Italia's cross appeal, and consequently recalculated the fine against Telecom Italia, reducing it to 115 million.

The Company, accordingly, has reduced the provision made in the 2004 financial year to the reserve for risks from 152 million to 115 million.

\* \* \*

In February 2005 the Antitrust Authority decided to open an investigation (Proceeding A357) under Law No. 287/1990 in respect of TIM, Vodafone and Wind to ascertain possible violations of Articles 81 and 82 of the EC Treaty.

The investigation was instigated by the complaints filed by some operators, who claimed that TIM, Vodafone and Wind had abused their collective dominant position in the market for mobile network infrastructure access services and their individual dominant position in the wholesale market for termination services on each mobile network, and had entered into agreements regarding access to the market for final mobile communications services and commercial offers to their own business customers.

In particular, TIM, Vodafone and Wind (alleged jointly to hold a dominant position in the market for network infrastructure access services) supposedly refused to negotiate agreements concerning the provision of access to the mobile networks, with the intent of obstructing the entry of other operators into the market for final mobile communications services, creating an understanding in restraint of trade.

According to the Authority, moreover, TIM, Vodafone and Wind (alleged to hold an individual dominant position in the market for mobile services) favored their own sales divisions by charging their competitors higher prices just for fixed-to-mobile termination service than those they offered to their own final business customers for integrated final fixed-mobile services.

Finally, the Authority suspects that the uniformity of such conduct in the retail market for mobile services, in terms of its exclusionary effects, could be the result of an understanding in restraint of trade.

According to the Authority, all the above-mentioned instances of conduct are likely to be detrimental to trade between the member states of the European Community inasmuch as they affect a substantial part of the common market, and consequently to violate Articles 81 and 82 of the EC Treaty.

The first hearing of TIM was held at the Authority in June 2005.

In February 2006 the Authority decided to extend the scope of the proceeding by including some instances of allegedly simultaneous conduct by TIM, Vodafone and Wind consisting in a refusal to renegotiate easier economic

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conditions for access to roaming on the GSM networks, thereby abusing their collective dominant position in that market. In the same measure, the Authority extended the time limit for concluding the proceeding to December 14, 2006.

**CHALLENGES TO MEASURES ADOPTED BY THE COMMUNICATIONS AUTHORITY**

The proceeding is pending in the appeal Telecom Italia filed with the Lazio Administrative Court in December 2004 for the annulment and interim suspension of Communications Authority Resolution No. 15/04/CIR of November 3, 2004 ( Assignment of the rights to use the numbers reserved to subscriber information services ).

The Authority's resolution follows up its Resolution No. 9/03/CIR of July 3, 2003. The latter updated the Numbering Plan in the telecommunications sector, establishing that the number 12XY would be assigned to subscriber information services. Accordingly, these services will have a number composed of the digits 12 followed by another two digits, different for each operator. The resolution provided that the implementing timetable, subjective requirements for the rights of use and the procedure for assigning the numbers dedicated to subscriber information services would be established in a subsequent resolution.

The Authority has set a very tight timetable for the cessation of all subscriber information services provided with numbers other than 12XY (including services accessed with the addition of 4 (e.g. 412, recently added to the traditional 12) and has also established the procedures for informing customers about the migration of these services to other numbers. Telecom Italia considers these procedures discriminatory, since the Company is not free to use its discretion in advertising the new number the service will migrate to.

**ETECSA**

Since 2002, Banco Nacional de Comercio Exterior ( Bancomext ) has accused ETECSA and Telan (majority shareholder of ETECSA, controlled by the Cuban government) of non-performance of alleged payment and guarantee obligations amounting to U.S.\$300 million established in a series of contracts between ETECSA, Telan, BanCuba (Central Bank of Cuba), Intesa BCI and Bancomext.

These accusations were the subject of an action brought by Bancomext before the Italian courts and of an international arbitration proceeding subsequently initiated by Telan and ETECSA, in which they pleaded that performance was impossible owing to a Cuban legislative measure prohibiting actions aimed at satisfying Bancomext's claim.

In the award issued on August 5, 2004, the arbitration board:

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- upheld ETECSA's argument that it was neither a debtor of Bancomext nor a guarantor of Telan;
- nonetheless determined that ETECSA remained obligated to satisfy the obligations to Bancomext deriving from the loan contract and, to restore the procedure envisaged for the payment of dividends belonging to Telan with a view to satisfying Bancomext. This decision, whose effects are retroactive, would oblige ETECSA to transfer around U.S.\$147 million to Telan, paying the sum into an escrow account in Bancomext's name.

ETECSA applied to the Paris Court of Appeal to declare the award null and void. In the meantime the Rome Court of Appeal, acting on a request from Bancomext, declared the award to be enforceable in Italy. The proceeding in the French courts is still pending.

ETECSA challenged the recognition of the award in Italy. On May 3, 2005, Bancomext sent notice of the award to ETECSA and Telan, together with a request for payment of an amount equal to the dividends distributed to Telan from April 2002. The related enforcement proceedings, undertaken by Bancomext at Telecom Italia, Telecom Italia Sparkle and TIM (all in their position as debtors of ETECSA), were suspended, however, in the light of a challenge filed by ETECSA to recognition of the award's enforceability in Italy.

In November 2005, at the conclusion of the first-level trial initiated by Bancomext before the Italian courts, the Court of Turin ordered ETECSA to pay Bancomext damages of approximately U.S.\$168 million and to restore the mechanism for the payment of dividends belonging to Telan, as contractually provided. ETECSA has appealed the first-level judgment.

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After the decision of the Court of Turin was published, in December 2005, Bancomext applied to the Court of Milan for the revival of the enforcement proceeding and the assignment of the seized goods. With this act Bancomext requested the court to convert the sequestration at Telecom Italia of the ETECSA's claims on the Company, which the Court of Turin had ordered in 2002 as a precautionary measure, into seizure and to assign Bancomext the sum of 2.8 million due by Telecom Italia.

ETECSA has challenged the enforcement proceeding initiated by Bancomext against ETECSA at Telecom Italia and the related trial is now pending.

In the meantime Telecom Italia International (in possession of a letter from the Cuban government relieving it of any injury arising from the reward) has asked the Cuban government, Bancuba and Telan to take every necessary step to avoid harmful consequences for its affiliate ETECSA, reserving its right to take protective action.

**BRAZIL**

On April 28, 2005, a final settlement was reached between the parties to a series of disputes in different venues involving Telecom Italia/Telecom Italia International versus respectively:

Brasil Telecom, for alleged abuses by the Group in extraordinary corporate actions undertaken by the Brazilian operator;

(i) Techold and Timepart, partners of Telecom Italia International in Solpart Participações (controller of Brasil Telecom through Brasil Telecom Participações), in arbitration in London before the International Chamber of Commerce of Paris, and (ii) Techold and Timepart and, with them, Solpart, Brasil Telecom Participações and Brasil Telecom, before the Court of Rio de Janeiro, in both cases in connection with the agreement concluded on August 27, 2002 for the temporary reduction from 37.29% to 19% of the Group's interest in the ordinary capital of Solpart and the temporary suspension of its governance rights, with an option for the repurchase of the aforesaid equity interest.

The above-mentioned disputes were definitively closed with the homologation of the settlement.

An exception is the action brought before the Court of Rio de Janeiro where some indirect shareholders of Techold, who have challenged the validity of the transaction and have so far succeeded in preventing its homologation. As things now stand, an objection on the matter is pending.

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On May 5, 2005, some indirect shareholders of Solpart petitioned the State Court of Rio de Janeiro to stay the implementation of an amendment to the shareholders' agreement signed on April 28, 2005, between the partners in Solpart (Telecom Italia International, Techold and Timepart) as well as any deed that would permit persons of the Telecom Italia Group to designate or remove directors of Brasil Telecom or its subsidiaries.

The judge only stayed the effects of the above mentioned amendment to the shareholders' agreement. Telecom Italia International appealed the order. Timepart then filed a petition for the recusal of the judge, upon which the same judge acknowledged valid grounds for such request. Consequently, the proceeding will continue with a new judge. The plaintiffs have initiated the trial proceeding.

\* \* \*

On June 30, 2005 Telecom Italia International filed a petition against some indirect shareholders of Solpart as well as against Techold, Timepart, Brasil Telecom Participações and Brasil Telecom, requesting a stay of the effectiveness of the Zain shareholders' agreement. Zain, an investment vehicle in which Brazilian pension funds and Citigroup-operated investment funds have interests, which indirectly controls Techold and of the put agreement executed between the above-mentioned pension funds and investment funds.

The agreements in question violate the Group's rights under the Solpart shareholders' agreement with respect to the transfer of direct or indirect shareholdings in Solpart.

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Telecom Italia International obtained the temporary measure prohibiting the sale of such shareholdings to third parties and initiated the proceeding on the merits of the case. Timepart then filed a petition for the recusal of the judge, upon which the same judge acknowledged valid grounds for such request. Consequently, the proceeding will continue with a new judge.

\* \* \*

On August 1, 2005, Telecom Italia International submitted a request to the International Chamber of Commerce of Paris (ICC) for an arbitration proceeding in London versus Techold, claiming non-performance of several provisions of the Solpart shareholders agreement and consequent damages. Telecom Italia International also petitioned for the validation of the above-mentioned amendment to the shareholders agreement (entered into on April 28, 2005) and, accordingly, for a declaration of Telecom Italia International's legitimate right to purchase the Solpart shares held by Techold at their fair market value less 10%. In October 2005, Techold filed its reply and counterclaim, requesting: (i) that Telecom Italia be made a party to the proceeding; (ii) a declaration of the invalidity of (a) the Settlement Agreement signed for the closure of the London arbitration proceeding of 2003 and (b) the April 2005 amendment of the shareholders agreement; (iii) a declaration that Telecom Italia International has no right to the restoration of its governance rights in Solpart and to convert and repurchase its own shares in Solpart; and (iv) ascertainment and imposition of damages for the alleged injury to Techold. In December 2005, Telecom Italia International filed its reply to Techold's counterclaim, requesting that Techold's demands be rejected; the ICC Court was also petitioned to dismiss Techold's demand that Telecom Italia be included in the proceeding. In February 2006 the ICC Court ruled for the exclusion of Telecom Italia S.p.A. The arbitration board is now being formed.

\* \* \*

On October 3, 2005, Telecom Italia International submitted a request to the ICC for an arbitration proceeding in Paris versus Techold and Timepart, claiming non-performance by Techold and Timepart of several provisions of the Solpart Master Agreement (SMA) signed on April 28, 2005 and consequent damages. In December 2005, Techold filed its reply and counterclaim, requesting: (i) that Telecom Italia be made a party to the proceeding; (ii) that the Solpart Master Agreement be declared invalid, and (iii) that damages be ascertained and imposed for the alleged injury to Techold. In January 2006, Telecom Italia International filed its reply to Techold's counterclaim, pleading its defenses and requesting that Techold's demands be rejected; the ICC Court was also petitioned to dismiss Techold's demand that Telecom Italia be included in the proceeding. In February 2006, in a prima facie ruling before the formation of the arbitration board, the ICC Court decided for the inclusion of Telecom Italia S.p.A. in the proceeding. The arbitration board is now being formed.

\* \* \*

On May 5, 2005, some indirect shareholders of Brasil Telecom obtained two preliminary injunctions against Telecom Italia International, TIM International, TIM Brasil, several companies of the Opportunity group and other Brasil Telecom companies to prevent the progress of the merger of Brasil Telecom Celular into TIM Brasil pursuant to the agreement concluded on April 28, 2005 between Brasil Telecom, Brasil Telecom Celular, TIM Brasil and TIM International. The plaintiffs subsequently initiated the trial proceeding.

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Telecom Italia International, TIM International and TIM Brasil promptly filed their defenses, objecting that the plaintiffs' allegations were unfounded in fact and law and appealing from both preliminary measures. After dismissal of their appeals, Telecom Italia International, TIM International and TIM Brasil filed a special appeal before a higher body, the Federal Court, which has agreed to examine the case only after the ruling on the merits of the dispute.

### **TELECOM ITALIA S.A.**

France Telecom brought an action before the Commercial Court of Paris against Telecom Italia S.A. (formerly Telecom Italia France) for alleged damages deriving from unfair trade practices.

Telecom Italia S.A. requested suspension of the proceedings until completion of the preliminary investigation currently pending before the district attorneys of Marseilles and Lyons for alleged illegalities in concluding contracts with final customers, initiated by complaints filed by consumers.

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**b) Employee benefit obligations under Law No. 58/1992**

Pursuant to Law No. 58/1992, Telecom Italia is required to provide full national insurance coverage for all employees on the payrolls of STET, SIP, Italcable and Telespazio as of February 20, 1992, as well as for all employees transferred from the Public Administration to the former Iritel, through the Telephone Companies Employees Social Security Fund (Fondo Previdenza Telefonici, FPT) which on January 1, 2000 became part of the general Employees Pension Fund.

At the present time, the amount of the liability can be estimated only roughly due to disagreements with the National Social Security Institute (Istituto Nazionale della Previdenza Sociale INPS) relating to the calculation of the amount due and the fact that at December 31, 2005 INPS had not yet notified the Company of all the positions to be covered.

The dispute with INPS concerns the application of the criteria established by Law No. 29/1979 for those employees (except for employees of the former Iritel) who had already applied for benefits pursuant to this law and which had not been processed by INPS. The parties have agreed that the differences in interpretation shall be settled through test appeals before the ordinary magistrate, with recourse to the Court of Appeals being waived for a final determination of the law in question. While proceedings are pending, Telecom Italia has agreed to pay, with reservation, the amounts requested by INPS, subject to subsequent equalization adjustments, if the Courts ultimately accept the Company's interpretation.

The amounts due were calculated by the INPS and are to be paid in 15 equal annual deferred installments (including annual interest of 5%), starting when INPS formally submits its requests.

The principal amount of the liability attributable to Telecom Italia as of December 31, 2005 was 1,094 million recorded under amounts due to social security authorities item (1,043 million as principal amount and 51 million as accrued interest, not yet paid) including 213 million due within 1 year.

**c) Commitments and other guarantees**

Guarantees provided amounted to 529 million, net of 474 million of counter-guarantees received, and consisted mainly of sureties provided by Telecom Italia on behalf of associates (of which 121 million in favour of AVEA I.H.A.S. and 142 million in favour 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 affiliates.

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Purchase and sale commitments at December 31, 2005 amounted to 316 million and 489 million, respectively, and referred to the part of commitments not falling within the normal operating cycle of the Group still to be fulfilled.

Purchase commitments consisted mainly of:

210 million of property leasing rentals under contracts lasting more than 6 years;

59 million of orders to suppliers of Telenergia relating to the electricity supply agreements reached with Endesa for the three-year period 2004-2006.

Sale commitments consisted mainly of:

431 million in respect of 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..

Companies included in the scope of the consolidation issued letters of patronage for a total of 295 million, chiefly on behalf of affiliates to guarantee insurance policies, lines of credit and overdraft arrangements.

Guarantees provided by third parties for obligations of Group companies referred to loans ( 1,610 million) and the performance of contracts ( 319 million). The total included sureties issued by BBVA for 817 million, by San Paolo IMI for 315 million and by Sumitomo for 73 million in respect of EIB loans for the TIM Mobile Network Project.

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Revenues amounted to 29,919 million, an increase of 1,627 million or 5.8% compared to year ended December 31, 2004. Details are as follows:

|  | Year ended December 31, |               |
|--|-------------------------|---------------|
|  | 2004                    | 2005          |
| (millions of Euro)                       |                         |               |
| <b>Sales:</b>                            |                         |               |
| • of telephone products                  | 1,595                   | 1,952         |
| • other sales                            | 584                     | 362           |
|  | <b>(A)</b>              | <b>2,314</b>  |
| <b>Services:</b>                         |                         |               |
| • traffic                                | 14,687                  | 15,577        |
| • subscription charges                   | 7,699                   | 8,020         |
| • fees                                   | 327                     | 361           |
| • other services                         | 3,224                   | 3,572         |
|  | <b>(B)</b>              | <b>27,530</b> |
| <b>Revenue on construction contracts</b> | <b>(C)</b>              | <b>75</b>     |
| <b>Total</b>                             | <b>(A+B+C)</b>          | <b>29,919</b> |

For a breakdown of revenue by segment/geographic area, reference should be made to the Note 39 Other information a) Segment information .

**NOTE 27 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        |
| <b>Total</b>  | <b>1,099</b>       | <b>678</b> |

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Purchases of materials and external services amount to 12,937 million, an increase of 9.5% compared to 2004 ( 11,812 million) and consist of the following:

|  |                | Year ended December 31, |               |
|--|----------------|-------------------------|---------------|
|  |                | 2004                    | 2005          |
|  |                | (millions of Euro)      |               |
| <b>Purchases of materials and merchandise for resale</b>     | <b>(A)</b>     | <b>2,203</b>            | <b>2,506</b>  |
| <b>Costs of services:</b>                                    |                |                         |               |
| 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>(B)</b>     | <b>8,661</b>            | <b>9,327</b>  |
| <b>Lease and rental costs:</b>                               |                |                         |               |
| Property lease rents   |                | 624                     | 641           |
| TLC circuit lease rent and rent for use of satellite systems |                | 154                     | 274           |
| Other lease and rental costs                                 |                | 170                     | 189           |
|  | <b>(C)</b>     | <b>948</b>              | <b>1,104</b>  |
| <b>Total</b>   | <b>(A+B+C)</b> | <b>11,812</b>           | <b>12,937</b> |

**NOTE 29 PERSONNEL COSTS**

Personnel costs amount to 4,142 million, an increase of 7.5% compared to 2004 ( 3,852 million). Such increase is almost entirely due to charges related to agreements of mobility pursuant to Law No. 223/91 and to the extraordinary executives termination benefit plan, for approximately 273 million. Excluding those items, the increase in personnel costs would be equal to 0.4%.

Personnel costs consist of the following:



|  | Year ended December 31, |              |
|--|-------------------------|--------------|
|  | 2004                    | 2005         |
|  | (millions of Euro)      |              |
| <b>Personnel costs at payroll:</b>   |                         |              |
| 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           |
|  | <b>(A)</b>              | <b>3,615</b> |
|  | <b>(B)</b>              | <b>38</b>    |
| <b>Temporary labour costs</b>  |                         | <b>52</b>    |
| <b>Miscellaneous expenses for personnel and for other labour-related services rendered:</b>                                    |                         |              |
| 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. 223/91 and to the extraordinary executives termination benefit plan |                         | 273          |
| Other  |                         | 9            |
|  | <b>(C)</b>              | <b>199</b>   |
| <b>Total</b>   | <b>(A+B+C)</b>          | <b>3,852</b> |
|  |                         | <b>4,142</b> |

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Personnel costs include, among others, costs relating to defined contribution plans.

The decrease in charge for Employee severance indemnities is due to the effect of the actuarial calculation of the Reserve for employee severance indemnities and the turnover of personnel working at the Italian companies of the Group.

Other employee-related costs include 4 million for the valuation of stock options and 81 million for other benefits to employees.

The average equivalent number of salaried personnel, excluding those of discontinued operations/assets held for sale and inclusive of personnel with temporary work contracts, in 2005 is 79,869 units (79,602 units in 2004). A 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           |
| <b>Total employees at payroll</b> | <b>77,649</b>           | <b>77,382</b> |
| <b>Temporary employees</b>        | <b>1,953</b>            | <b>2,487</b>  |
| <b>Total employees</b>            | <b>79,602</b>           | <b>79,869</b> |

Employees at December 31, 2005, excluding those relating to discontinued operations/assets held for sale, is 85,484 units (82,620 units at December 31, 2004), with an increase of 2,864 units.

Employees by segment are analyzed in the Note 39 Other information a) Segment Information .

**NOTE 30 OTHER OPERATING EXPENSES**

Other operating expenses amount to 1,468 million, with a decrease of 135 million compared to 2004 and 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          |
| <b>Total</b>  | <b>1,603</b>            | <b>1,468</b> |

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**NOTE 31 CAPITALIZED INTERNAL CONSTRUCTION COSTS**

Capitalized internal construction costs amount to 471 million, a reduction of 242 million compared to 2004, and consist of the following:

|  | Year ended December 31, |            |
|--|-------------------------|------------|
|  | 2004                    | 2005       |
|  | (millions of Euro)      |            |
| <b>Infra-group revenues for the sale of:</b>       |                         |            |
| • Intangible assets with a finite life             | 49                      | 105        |
| • Tangible assets                                  | 18                      | 29         |
|  | <b>(A)</b>              | <b>134</b> |
| <b>Capitalized internal construction costs on:</b> |                         |            |
| • Intangible assets with a finite life             | 473                     | 182        |
| • Property, plant and equipment owned              | 173                     | 155        |
|  | <b>(B)</b>              | <b>337</b> |
| <b>Total</b>                                       | <b>(A+B)</b>            | <b>471</b> |

The reduction from 2004 is due to the use of a different accounting method. In 2004, the external costs relating to contracts that were to be capitalized passed through the statement of operations, whereas, in 2005, such costs are booked directly to the capital asset account.

**NOTE 32 DEPRECIATION AND AMORTIZATION**

Depreciation and amortization charges amount to 5,232 million, an increase of 424 million compared to 2004. Details are as follows:

| Year ended December 31, |      |
|-------------------------|------|
| 2004                    | 2005 |
| (millions of Euro)      |      |

|  |                      |              |
|--|----------------------|--------------|
| <b>Amortization of Intangible assets with a finite life:</b>     |                      |              |
| Industrial patents and intellectual property rights              | 1,106                | 1,414        |
| Concessions, licenses, trademarks and similar rights             | 224                  | 253          |
| Other intangible assets  | 16                   | 17           |
|  |                      |              |
| <b>(A)</b>   | <b>1,346</b>         | <b>1,684</b> |
| <b>Depreciation of Tangible assets owned:</b>                    |                      |              |
| 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>(B)</b>   | <b>3,324</b>         | <b>3,416</b> |
| <b>Depreciation of Tangible assets held under finance lease:</b> |                      |              |
| Civil and industrial buildings                                   | 93                   | 93           |
| Plant and equipment  |                      | 1            |
| Aircrafts and ships  | 4                    | 4            |
| Other assets   | 41                   | 34           |
|  |                      |              |
| <b>(C)</b>   | <b>138</b>           | <b>132</b>   |
| <b>Total</b>   | <b>(A+B+C) 4,808</b> | <b>5,232</b> |

An analysis of depreciation and amortization by sector is presented in the Note 39 Other information a) Segment Information .

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Capital gains/losses realized on the disposal of non-current assets amount to 242 million, an increase of 251 million compared to 2004. Details are as follows:

|   | Year ended December 31, |            |
|---|-------------------------|------------|
|   | 2004                    | 2005       |
|   | (millions of Euro)      |            |
| <b>Capital gains realized on the disposal of non-current assets:</b>      |                         |            |
| Gains on the retirement/disposal of intangible and tangible assets        | 17                      | 283        |
| Gains on the disposal of business segments                                | 6                       |            |
| Gains on the disposal of equity investments in consolidated subsidiaries  | 4                       |            |
|   | <b>(A)</b>              | <b>283</b> |
| <b>Capital losses incurred on the disposal of non-current assets:</b>     |                         |            |
| Losses on the retirement/disposal of intangible and tangible assets       | 27                      | 40         |
| Losses on the disposal of equity investments in consolidated subsidiaries | 9                       | 1          |
|   | <b>(B)</b>              | <b>41</b>  |
| <b>Total</b>  | <b>(A-B)</b>            | <b>242</b> |

Capital gains on the retirement/disposal of intangible and tangible assets in 2005 include 264 million for the gain, net of incidental charges, realized on the contribution of 561 properties to the Fondo Raissa and 246 properties to the Fondo Spazio Industriale under the plan which calls for the sale of more than 1,300 properties for a total amount of about 1 billion. Additional details are disclosed in the Note 8 Tangible assets (owned and under finance lease) .

**NOTE 34 IMPAIRMENT LOSSES/REVERSALS ON NON-CURRENT ASSETS**

Impairment losses on non-current assets are 28 million. In 2004, the total was a negative 444 million and included the charges connected with the De Agostini settlement for the purchase of a 40% stake in Finanziaria Web ( 282 million) in addition to the net impairments of intangible and tangible assets ( 162 million).

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Financial income amounts to 3,144 million, an increase of 939 million compared to 2004.

Details are as follows:

|  | Year ended December 31, |              |
|--|-------------------------|--------------|
|  | 2004                    | 2005         |
|  | (millions of Euro)      |              |
| <b>Income from equity investments</b>  | <b>(A) 212</b>          | <b>95</b>    |
| <b>Other financial income:</b>   |                         |              |
| Income from financial receivables classified as Non-current assets   | 19                      | 15           |
| Income from securities other than equity investments, classified as Non-current assets   | 1                       |              |
| Income from securities other than equity investments, classified as Current assets   | 52                      | 31           |
| Other financial income:  |                         |              |
| Interest income  | 164                     | 219          |
| Foreign exchange gains   | 312                     | 535          |
| Income from fair value hedge derivatives   | 290                     | 465          |
| Reversal of the Reserve for fair value adjustments of cash flow hedge derivatives (interest rate component) to the statement of operations | 56                      | 180          |
| Income from non-hedging derivatives  | 166                     | 80           |
| Miscellaneous financial income   | 137                     | 476          |
|  | <b>(B) 1,197</b>        | <b>2,001</b> |
| <b>Positive fair value adjustments to:</b>   |                         |              |
| Fair value hedge derivatives   | 88                      | 693          |
| Underlying financial assets and liabilities of fair value hedges   | 548                     | 167          |
| Non-hedging derivative financial instruments   | 132                     | 185          |
|  | <b>(C) 768</b>          | <b>1,045</b> |
| <b>Impairment reversals on financial assets</b>  | <b>(D) 28</b>           | <b>3</b>     |
| <b>Total</b>   | <b>(A+B+C+D) 2,205</b>  | <b>3,144</b> |

Income from equity investments ( 95 million) included gains on the sale of the equity investments in C-Mobil ( 61 million), Intelsat ( 2 million) and Golden Lines ( 5 million). In 2004, such income included the gain on the sale of the residual interest in Telekom Austria

( 86 million) and the gain on sale of the remaining interest in Mirror International ( 85 million).

Foreign exchange gains ( 535 million) increased by 223 million compared to 2004. This amount was reduced by 21 million for the foreign exchange losses originating from the reversal of the Reserve for fair value adjustments of cash flow hedge derivatives to the statement of operations ( 178 million in 2004).

Miscellaneous financial income increased by 339 million and included the release ( 423 million) of reserves provided in prior years in relation to sureties issued to the banks which had financed the associate AVEA I.H.A.S., since there was no longer a risk after the guarantees were cancelled in part.

Income from fair value hedge derivatives ( 465 million) increased by 175 million compared to 2004 ( 290 million) and include 159 million on CCIRS contracts and 306 million on IRS contracts.

Reversal of the Reserve for fair value adjustments of cash flow hedge derivatives (interest rate component) to the statement of operations ( 180 million) increased by 124 million compared to 2004 ( 56 million) and includes 125 million on CCIRS contracts and 55 million on IRS contracts.

Income from non-hedging derivatives ( 80 million) decreased by 86 million compared to 2004 ( 166 million) and includes 6 million on CCIRS contracts, 56 million on IRS contracts and 18 million on other derivative contracts.



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Positive fair value adjustments to fair value hedges ( 693 million) increased by 605 million compared to 2004 ( 88 million) and include 612 million on CCIRS contracts and 81 million on IRS contracts, with a counterbalance to negative fair value adjustments of underlying financial assets and liabilities of fair value hedges, which amount to 689 million ( 88 million in 2004). Additional details are provided in the Note 36 Financial expenses .

Positive fair value adjustments of underlying financial assets and liabilities of fair value hedges ( 167 million) decreased by 381 million compared to 2004 ( 548 million). The counterbalance of such amount is represented by the negative fair value adjustments of the corresponding fair value hedge derivatives which amount to 157 million ( 547 million in 2004). Additional details are provided in the Note 36 Financial expenses .

Positive fair value adjustments of non-hedging derivative financial instruments ( 185 million) include 45 million for the fair value adjustment of the call option on Sofora shares.

**NOTE 36 FINANCIAL EXPENSES**

Financial expenses amount to 5,131 million, an increase of 934 million compared to 2004.

Details are as follows:

|  | Year ended December 31, |              |
|--|-------------------------|--------------|
|  | 2004                    | 2005         |
|  | (millions of Euro)      |              |
| <b>Interest expense and other borrowing costs:</b>   |                         |              |
| Interest expense and other costs relating to bonds   | 2,064                   | 2,056        |
| Interest expense to banks  | 45                      | 296          |
| Interest expense others  | 224                     | 214          |
| Commissions  | 82                      | 61           |
| Foreign exchange losses  | 330                     | 433          |
| Charges from fair value hedge derivatives  | 152                     | 264          |
| Reversal of the Reserve for fair value adjustments of cash flow hedge derivatives (interest rate component) to the statement of operations | 155                     | 255          |
| Charges from non-hedging derivative financial instruments  | 114                     | 170          |
| Miscellaneous financial expense  | 156                     | 223          |
|  | <b>(A) 3,322</b>        | <b>3,972</b> |
| <b>Negative fair value adjustments to:</b>   |                         |              |
| Fair value hedge derivatives   | 547                     | 157          |

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|  |                   |                   |
|--|-------------------|-------------------|
| Underlying financial assets and liabilities of fair value hedges   | 88                | 689               |
| Non-hedging derivative financial instruments   | 136               | 289               |
|  | <u>          </u> | <u>          </u> |
| <b>(B)</b>   | <b>771</b>        | <b>1,135</b>      |
|  | <u>          </u> | <u>          </u> |
| <b>Impairment losses on financial assets (equity investments and securities other than equity investments)</b> | <b>(C)</b>        | <b>24</b>         |
|  | <u>          </u> | <u>          </u> |
| <b>Total</b>   | <b>(A+B+C)</b>    | <b>5,131</b>      |
|  | <u>          </u> | <u>          </u> |

Interest expense to banks ( 296 million) increased by 251 million compared to 2004 ( 45 million), mainly for financing of the Cash Tender Offer on TIM shares.

Foreign exchange losses ( 433 million) increased by 103 million compared to 2004. Such amount is net of 341 million of foreign exchange gains arising from the reversal of the Reserve for fair value adjustments of cash flow hedge derivatives to the statement of operations.

Charges from fair value hedge derivatives ( 264 million) increased by 112 million compared to 2004 ( 152 million) and include 89 million on CCIRS contracts and 175 million on IRS contracts.

Reversal of the Reserve for fair value adjustments of cash flow hedge derivatives (interest rate component) to the statement of operations ( 255 million) increased by 100 million compared to 2004 ( 155 million) and includes 138 million on CCIRS contracts and 117 million on IRS contracts.

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Charges from non-hedging derivative financial instruments ( 170 million) increased by 56 million compared to 2004 ( 114 million) and refer to 121 million on CCIRS contracts, 22 million on IRS contracts and 28 million on other derivative contracts.

Negative fair value adjustments to fair value hedges ( 157 million) decreased by 390 million compared to 2004. The total amount includes 148 million on IRS contracts and 9 million on CCIRS contracts with a counterbalance by positive fair value adjustments of underlying financial assets and liabilities of fair value hedge derivatives which amount to 167 million ( 548 million in 2004). Additional details are provided in the Note 35 Financial income .

Negative fair value adjustments of underlying financial assets and liabilities of fair value hedges ( 689 million) increased by 601 million compared to 2004 ( 88 million). Such amount is counterbalanced by the positive fair value adjustments of the corresponding fair value hedge derivatives which amount to 693 million ( 88 million in 2004). Additional details are provided in the Note 35 Financial Income .

**NOTE 37 INCOME TAXES FOR THE YEAR**

Income taxes on continuing operations for the year ended December 31, 2005 and 2004 are detailed as follows:

|   | Year ended December 31, |              |
|---|-------------------------|--------------|
|   | 2004                    | 2005         |
|   | (millions of Euro)      |              |
| Current taxes for the year  | 1,387                   | 1,017        |
| Current taxes for prior years   | 10                      | 29           |
| Reversal of income taxes of prior years                                       | (16)                    | (37)         |
| <b>Total current taxes</b>  | <b>1,381</b>            | <b>1,009</b> |
| Deferred taxes  | 1,273                   | 1,386        |
| <b>Total income taxes on continuing operations (A)</b>                        | <b>2,654</b>            | <b>2,395</b> |
| Current taxes for the year  | 79                      | 23           |
| Deferred taxes  | 16                      | 8            |
| <b>Total income taxes on discontinued operations/assets held for sale (B)</b> | <b>95</b>               | <b>31</b>    |
| <b>Total income taxes for the year (A+B)</b>                                  | <b>2,749</b>            | <b>2,426</b> |

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Income taxes on Discontinued operations/assets held for sale are classified in the statement of operations in Net income/(loss) from Discontinued operations/assets held for sale .

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Income before taxes and the tax charge on income for the years ended December 31, 2005 and 2004 are summarized as follows:

|   | Year ended December 31, |              |
|---|-------------------------|--------------|
|   | 2004                    | 2005         |
|   | (millions of Euro)      |              |
| <b>Income before taxes:</b>                         |                         |              |
| • from continuing operations                        | 5,606                   | 5,535        |
| • from discontinued operations/assets held for sale | (23)                    | 581          |
| <b>Total income before taxes</b>                    | <b>5,583</b>            | <b>6,116</b> |
| <i>Of which:</i>                                    |                         |              |
| • <i>Italy</i>                                      | 6,153                   | 5,789        |
| • <i>Foreign</i>                                    | (570)                   | 327          |
| <b>Current taxes:</b>                               |                         |              |
| • Italy   | 1,359                   | 957          |
| • Foreign   | 101                     | 75           |
| <b>Total current taxes (A)</b>                      | <b>1,460</b>            | <b>1,032</b> |
| <b>Deferred taxes:</b>                              |                         |              |
| • Italy   | 1,227                   | 1,457        |
| • Foreign   | 62                      | (63)         |
| <b>Total deferred taxes (B)</b>                     | <b>1,289</b>            | <b>1,394</b> |
| <b>Total income taxes (A+B)</b>                     | <b>2,749</b>            | <b>2,426</b> |

The reconciliation between the nominal tax rate according to Italian law and the effective tax rate resulting from the consolidated financial statements and the corresponding theoretical and effective tax charges is the following:

|  | Year ended December 31, |     |                    |     |
|--|-------------------------|-----|--------------------|-----|
|  | 2004                    |     | 2005               |     |
|  | (millions of Euro)      | %   | (millions of Euro) | %   |
| <b>Income before taxes</b>                         | <b>5,488</b>            |     | <b>6,085</b>       |     |
| Taxes calculated at the 33% tax rate in force      | 1,811                   | 33% | 2,008              | 33% |
| Tax losses for the year not considered recoverable | 168                     | 3%  | 81                 | 1%  |
|  | (15)                    |     | (3)                |     |

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|  |                     |                   |                     |                   |
|--|---------------------|-------------------|---------------------|-------------------|
| Tax losses not considered recoverable in previous years and recovered during the year        |                     |                   |                     |                   |
| Deferred tax benefits not recorded in prior years and considered recoverable during the year | (161)               | (3%)              | (21)                |                   |
| Reversal of the reserve for deferred taxes   |                     |                   | (136)               | (2%)              |
| Permanent differences:   |                     |                   |                     |                   |
| Non-deductible costs   | 290                 | 5%                | 156                 | 3%                |
| Other net differences  | (84)                | (1%)              | (170)               | (3%)              |
|  | <u>2,009</u>        | <u>37%</u>        | <u>1,915</u>        | <u>32%</u>        |
| IRAP and other taxes calculated on a different basis other than income before taxes          | 740                 | 13%               | 511                 | 8%                |
|  | <u>740</u>          | <u>13%</u>        | <u>511</u>          | <u>8%</u>         |
| <b>Total effective taxes booked to the statement of operations</b>                           | <b><u>2,749</u></b> | <b><u>50%</u></b> | <b><u>2,426</u></b> | <b><u>40%</u></b> |

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The potential shares originating from the conversions of stock options and convertible notes and bonds have an anti-dilutive effect and therefore the corresponding shares have not been considered in the calculation of earnings per share.

The additional dividend (at an invariable amount of 0.011) due to the Savings Shares was allocated entirely to continuing operations.

|   | Year ended December 31, |              |
|---|-------------------------|--------------|
|   | 2004                    | 2005         |
| <b>Basic And Diluted Earnings Per Share</b>   |                         |              |
| Net income attributable to the Group  | 1,815                   | 3,216        |
| Less: additional dividend per Savings Shares ( 0.011 per share)                               | (64)                    | (65)         |
| (millions of Euro)  | <b>1,751</b>            | <b>3,151</b> |
| Weighted average number of Ordinary and Savings Shares (million)                              | 16,004                  | 18,213       |
| Basic and diluted earnings per share Ordinary Shares  | 0.11                    | 0.17         |
| Plus: 0.011 additional dividend per Savings Shares  | 0.01                    | 0.01         |
| Basic and diluted earnings per share Savings Shares (Euro)                                    | <b>0.12</b>             | <b>0.18</b>  |
| <b>Basic And Diluted Earnings Per Share From Continuing Operations</b>                        |                         |              |
| Net income from continuing operations   | 1,933                   | 2,666        |
| Less: additional dividend per Savings Shares  | (64)                    | (65)         |
| (millions of Euro)  | <b>1,869</b>            | <b>2,601</b> |
| Weighted average number of Ordinary and Savings Shares (million)                              | 16,004                  | 18,213       |
| Basic and diluted earnings per share from continuing operations Ordinary Shares               | 0.12                    | 0.14         |
| Plus: 0.011 additional dividend per Savings Shares  | 0.01                    | 0.01         |
| Basic and diluted earnings per share from continuing operations Savings Shares (Euro)         | <b>0.13</b>             | <b>0.15</b>  |
| <b>Basic And Diluted Earnings Per Share From Discontinued Operations/Assets Held For Sale</b> |                         |              |
| (millions of Euro)  | (118)                   | 550          |

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Net income (loss) from discontinued operations/assets held for sale

|   |           |                       |                       |
|---|-----------|-----------------------|-----------------------|
| Weighted average number of Ordinary and Savings Shares  | (million) | 16,004                | 18,213                |
| Basic and diluted earnings (loss) per share from discontinued operations/assets held for sale Ordinary Shares | (Euro)    | (0.01)                | 0.03                  |
| Basic and diluted earnings (loss) per share from discontinued operations/assets held for sale Savings Shares  | (Euro)    | (0.01)                | 0.03                  |
| Weighted average number of Ordinary Shares  |           | 10,208,327,613        | 12,283,195,845        |
| Weighted average number of Savings Shares   |           | 5,795,921,069         | 5,930,204,164         |
| <b>Total</b>  |           | <b>16,004,248,682</b> | <b>18,213,400,009</b> |

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**NOTE 39 OTHER INFORMATION**

**a) Segment Information**

The integration of fixed-mobile operations under a single organizational structure has resulted in a overall reorganization of the Group which, from October 5, 2005, is structured as follows:

**Central Functions**, which are responsible for directing the Telecom Italia Group s operations, have been reorganized into **Group Functions** and/or **Service Units**:

- **Group Functions** are responsible for ensuring coordination, direction and control at the Group level, in the spheres of activities, ensuring, in particular, the definition of policies and the overall administration of matters common to all Business Units;
- **Service Units** are responsible in close cooperation with Operations and the Business Units for the performance of common operating activities to support the business.

**Operations**, which is responsible for the management and development of fixed and mobile telecommunications and internet services. Operations, for reporting purposes in these financial statements, 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.

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The macro-organizational model of the Telecom Italia Group is nevertheless interconnected in a flexible manner with the corporate structure, giving priority to identifying competency in specific business areas/functions rather than closely following the legal organizational structures.

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|   | Wireline           |               | Mobile        |               | Media       |              | Olivetti   |             | Other activities |              | Adjustments and eliminations |                | Consolidated Total |               |
|---|--------------------|---------------|---------------|---------------|-------------|--------------|------------|-------------|------------------|--------------|------------------------------|----------------|--------------------|---------------|
|   | 2004               | 2005          | 2004          | 2005          | 2004        | 2005         | 2004       | 2005        | 2004             | 2005         | 2004                         | 2005           | 2004               | 2005          |
|   | (millions of Euro) |               |               |               |             |              |            |             |                  |              |                              |                |                    |               |
| Third-party revenues  | 15,844             | 16,348        | 11,457        | 12,672        | 165         | 176          | 536        | 400         | 290              | 323          |                              |                | 28,292             | 29,919        |
| Intragroup revenues   | 1,587              | 1,454         | 255           | 291           | 3           | 4            | 54         | 52          | 1,345            | 1,357        | (3,244)                      | (3,158)        |                    |               |
| Revenues by segment   | <b>17,431</b>      | <b>17,802</b> | <b>11,712</b> | <b>12,963</b> | <b>168</b>  | <b>180</b>   | <b>590</b> | <b>452</b>  | <b>1,635</b>     | <b>1,680</b> | <b>(3,244)</b>               | <b>(3,158)</b> | <b>28,292</b>      | <b>29,919</b> |
| Other income  | 578                | 294           | 386           | 192           | 20          | 11           | 18         | 22          | 179              | 226          | (82)                         | (67)           | 1,099              | 678           |
| <b>Total operating revenues and other income</b>                              | <b>18,009</b>      | <b>18,096</b> | <b>12,098</b> | <b>13,155</b> | <b>188</b>  | <b>191</b>   | <b>608</b> | <b>474</b>  | <b>1,814</b>     | <b>1,906</b> | <b>(3,326)</b>               | <b>(3,225)</b> | <b>29,391</b>      | <b>30,597</b> |
| Purchases of materials and external services                                  | (6,986)            | (7,485)       | (5,650)       | (6,337)       | (161)       | (200)        | (443)      | (388)       | (1,550)          | (1,565)      | 2,978                        | 3,038          | (11,812)           | (12,937)      |
| Personnel costs   | (2,525)            | (2,708)       | (631)         | (707)         | (69)        | (75)         | (111)      | (100)       | (536)            | (571)        | 20                           | 19             | (3,852)            | (4,142)       |
| Other operating expenses  | (995)              | (557)         | (430)         | (640)         | (27)        | (12)         | (25)       | (11)        | (123)            | (278)        | (3)                          | 30             | (1,603)            | (1,468)       |
| Changes in inventories  | 39                 | (30)          | (7)           | 14            | 1           | 3            | (1)        | 9           | (5)              |              |                              |                | 27                 | (4)           |
| Capitalized internal construction costs                                       | 267                | 281           | 41            | 55            | 4           | 2            |            | 1           | 65               | 3            | 336                          | 129            | 713                | 471           |
| Depreciation and amortization   | (2,902)            | (2,995)       | (1,549)       | (1,870)       | (28)        | (38)         | (16)       | (16)        | (392)            | (377)        | 79                           | 64             | (4,808)            | (5,232)       |
| Gains/losses on disposals of non-current assets                               | (25)               | (25)          | (3)           |               | 1           | (1)          | 8          |             | 31               | 268          | (21)                         |                | (9)                | 242           |
| Impairment losses on non-current assets                                       | (126)              | (11)          | (19)          | (9)           | (2)         |              | (3)        | (7)         | (19)             | (1)          | (275)                        |                | (444)              | (28)          |
| <b>Operating income</b>   | <b>4,756</b>       | <b>4,566</b>  | <b>3,850</b>  | <b>3,661</b>  | <b>(93)</b> | <b>(130)</b> | <b>17</b>  | <b>(38)</b> | <b>(715)</b>     | <b>(615)</b> | <b>(212)</b>                 | <b>55</b>      | <b>7,603</b>       | <b>7,499</b>  |
| Share of earnings of equity investments accounted for using the equity method | 2                  | 2             |               | (122)         |             |              |            |             | (7)              | 143          |                              |                | (5)                | 23            |
| Financial income  |                    |               |               |               |             |              |            |             |                  |              |                              |                | 2,205              | 3,144         |
| Financial expenses  |                    |               |               |               |             |              |            |             |                  |              |                              |                | (4,197)            | (5,131)       |
| <b>Income from continuing operations before taxes</b>                         |                    |               |               |               |             |              |            |             |                  |              |                              |                | <b>5,606</b>       | <b>5,535</b>  |
| Income taxes  |                    |               |               |               |             |              |            |             |                  |              |                              |                | (2,654)            | (2,395)       |
| <b>Net income from continuing operations</b>                                  |                    |               |               |               |             |              |            |             |                  |              |                              |                | <b>2,952</b>       | <b>3,140</b>  |
| Net income (loss) from discontinued operations /assets held for sale          |                    |               |               |               |             |              |            |             |                  |              |                              |                | (118)              | 550           |
| <b>Net income</b>   |                    |               |               |               |             |              |            |             |                  |              |                              |                | <b>2,834</b>       | <b>3,690</b>  |

of which:

|   |       |       |
|---|-------|-------|
| Net income attributable to the Group          | 1,815 | 3,216 |
| Net income attributable to Minority interests | 1,019 | 474   |

## Segment capital expenditure information

|                   | Wireline           |              | Mobile       |              | Media     |           | Olivetti  |           | Other activities |            | Adjustments and eliminations |            | Consolidated Total |              |
|-------------------|--------------------|--------------|--------------|--------------|-----------|-----------|-----------|-----------|------------------|------------|------------------------------|------------|--------------------|--------------|
|                   | 2004               | 2005         | 2004         | 2005         | 2004      | 2005      | 2004      | 2005      | 2004             | 2005       | 2004                         | 2005       | 2004               | 2005         |
|                   | (millions of Euro) |              |              |              |           |           |           |           |                  |            |                              |            |                    |              |
| Intangible assets | 947                | 804          | 765          | 849          | 23        | 38        | 1         | 1         | 146              | 100        |                              | (7)        | 1,882              | 1,785        |
| Tangible assets   | 1,320              | 1,866        | 1,523        | 1,269        | 16        | 27        | 14        | 18        | 247              | 208        |                              |            | 3,120              | 3,388        |
| <b>Total</b>      | <b>2,267</b>       | <b>2,670</b> | <b>2,288</b> | <b>2,118</b> | <b>39</b> | <b>65</b> | <b>15</b> | <b>19</b> | <b>393</b>       | <b>308</b> |                              | <b>(7)</b> | <b>5,002</b>       | <b>5,173</b> |

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|           | Wireline                         |                         | Mobile                           |                         | Media                            |                         | Olivetti                         |                         | Other activities                 |                         | Consolidated Total               |                         |        |
|-----------|----------------------------------|-------------------------|----------------------------------|-------------------------|----------------------------------|-------------------------|----------------------------------|-------------------------|----------------------------------|-------------------------|----------------------------------|-------------------------|--------|
|           | As of December 31, 2004 adjusted | As of December 31, 2005 | As of December 31, 2004 adjusted | As of December 31, 2005 | As of December 31, 2004 adjusted | As of December 31, 2005 | As of December 31, 2004 adjusted | As of December 31, 2005 | As of December 31, 2004 adjusted | As of December 31, 2005 | As of December 31, 2004 adjusted | As of December 31, 2005 |        |
|           | (number of employees)            |                         |                                  |                         |                                  |                         |                                  |                         |                                  |                         |                                  |                         |        |
| Employees | 54,090                           | 55,990                  | 18,743                           | 20,767                  | 1,077                            | 886                     | 2,109                            | 1,750                   | 6,601                            | 6,091                   | 82,620                           | 85,484                  | 89,000 |

**Segment other information (\*)**

|                       | Wireline                         |                         | Mobile                           |                         | Media                            |                         | Olivetti                         |                         | Other activities                 |                         | Adjustments and eliminations     |                         | Consolidated Total               |                         |
|-----------------------|----------------------------------|-------------------------|----------------------------------|-------------------------|----------------------------------|-------------------------|----------------------------------|-------------------------|----------------------------------|-------------------------|----------------------------------|-------------------------|----------------------------------|-------------------------|
|                       | As of December 31, 2004 adjusted | As of December 31, 2005 | As of December 31, 2004 adjusted | As of December 31, 2005 | As of December 31, 2004 adjusted | As of December 31, 2005 | As of December 31, 2004 adjusted | As of December 31, 2005 | As of December 31, 2004 adjusted | As of December 31, 2005 | As of December 31, 2004 adjusted | As of December 31, 2005 | As of December 31, 2004 adjusted | As of December 31, 2005 |
|                       | (millions of Euro)               |                         |                                  |                         |                                  |                         |                                  |                         |                                  |                         |                                  |                         |                                  |                         |
| Operating assets      | 35,616                           | 35,375                  | 22,219                           | 41,622                  | 389                              | 591                     | 339                              | 305                     | 4,044                            | 4,022                   | (1,256)                          | (3,114)                 | 61,351                           | 78,800                  |
| Goodwill              | 7                                | 7                       |                                  |                         |                                  |                         | 1                                | 1                       | 577                              | 773                     |                                  |                         | 585                              | 773                     |
| Intangible assets     |                                  |                         |                                  |                         |                                  |                         |                                  |                         |                                  |                         |                                  |                         | 4,719                            | 5,000                   |
| Other assets          |                                  |                         |                                  |                         |                                  |                         |                                  |                         |                                  |                         |                                  |                         | 15,342                           | 15,900                  |
|                       |                                  |                         |                                  |                         |                                  |                         |                                  |                         |                                  |                         |                                  |                         | <b>81,997</b>                    | <b>96,000</b>           |
| Operating liabilities | 9,653                            | 9,632                   | 5,508                            | 6,106                   | 155                              | 201                     | 287                              | 252                     | 1,752                            | 2,711                   | (968)                            | (2,954)                 | 16,387                           | 15,900                  |
| Other liabilities     |                                  |                         |                                  |                         |                                  |                         |                                  |                         |                                  |                         |                                  |                         | 2,243                            | 2,243                   |
| Equity                |                                  |                         |                                  |                         |                                  |                         |                                  |                         |                                  |                         |                                  |                         | 42,569                           | 52,700                  |
|                       |                                  |                         |                                  |                         |                                  |                         |                                  |                         |                                  |                         |                                  |                         | 20,798                           | 26,900                  |

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81,997 96,0

(\*) Data as of December 31, 2005 by business segment are compared with data as of December 31, 2004 adjusted considering discontinued operations/assets held for sale the same companies as those considered as of December 31, 2005, i.e. the Finsiel group, Corporacion Digitel, the Entel Chile group, TIM Hellas, TIM Perù and Gruppo Buffetti.

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|   | Period           | Discontinued Operations/Assets held for sale |          |                      |           | Sub-total | Other adjustments and eliminations(3) | Total  |
|---|------------------|--|----------|----------------------|-----------|-----------|---------------------------------------|--------|
|   |                  | Mobile(1)                                    | Media(2) | Entel<br>Chile group | IT Market |           |                                       |        |
| (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                                     | 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, Corporaçion 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 Corporaçion Digitel).

(1) Includes TIM Hellas, TIM Perù and Corporaçion 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 relative incidental charges) and TIM Perù ( 120 million, net of the relative 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;

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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).

### b) Disclosure by geographical area

Breakdown of revenues by customer geographic location:

|                            | <u>2004</u>          | <u>2005</u>          |
|----------------------------|----------------------|----------------------|
|                            | (millions of Euro)   |                      |
| Italy                      | 23,736               | 23,754               |
| Rest of Europe             | 1,746                | 2,265                |
| North America              | 398                  | 374                  |
| Central and South America  | 2,036                | 3,147                |
| Australia, Africa and Asia | 376                  | 379                  |
| <b>Total</b>               | <b><u>28,292</u></b> | <b><u>29,919</u></b> |

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Operating assets by geographic area:

|                            | 2004               | 2005          |
|----------------------------|--------------------|---------------|
|                            | (millions of Euro) |               |
| Italy                      | 57,099             | 71,072        |
| Rest of Europe             | 2,554              | 1,722         |
| North America              | 30                 | 14            |
| Central and South America  | 4,885              | 5,962         |
| Australia, Africa and Asia | 55                 | 31            |
| <b>Total</b>               | <b>64,623</b>      | <b>78,801</b> |

Capital expenditures in tangible and intangible assets by geographic area:

|                            | 2004               | 2005         |
|----------------------------|--------------------|--------------|
|                            | (millions of Euro) |              |
| Italy                      | 3,955              | 3,992        |
| Rest of Europe             | 204                | 313          |
| North America              | 8                  | 6            |
| Central and South America  | 835                | 861          |
| Australia, Africa and Asia |                    | 1            |
| <b>Total</b>               | <b>5,002</b>       | <b>5,173</b> |

Employees by geographic area:

|                            | Executives                        | Middle management | White collars | Blue collars | Temporary employees | Total at December 31, 2005 | Total at December 31, 2004 |
|----------------------------|-----------------------------------|-------------------|---------------|--------------|---------------------|----------------------------|----------------------------|
|                            | (number of employees at year end) |                   |               |              |                     |                            |                            |
| Italy                      | 1,395                             | 4,227             | 63,786        | 660          | 1,919               | 71,987                     | 72,828                     |
| Rest of Europe             | 46                                | 210               | 1,781         | 1            | 782                 | 2,820                      | 2,893                      |
| North America              | 4                                 | 26                | 18            | 2            |                     | 50                         | 145                        |
| Central and South America  | 28                                | 414               | 9,475         | 6            | 681                 | 10,604                     | 13,236                     |
| Australia, Africa and Asia | 3                                 | 12                | 8             |              |                     | 23                         | 49                         |
| <b>Total</b>               | <b>1,476</b>                      | <b>4,889</b>      | <b>75,068</b> | <b>669</b>   | <b>3,382</b>        | <b>85,484</b>              | <b>89,151</b>              |



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**Table of Contents****Financial Statements****Notes To Consolidated Financial Statements****c) Exchange rate used to translate foreign currency financial statements(1)**

|  | Year-end exchange rates<br>(Balance sheet) |                               | Average exchange rates for the year<br>(Statement of operations) |                                    |
|--|--|-------------------------------|--|------------------------------------|
|  | As of<br>December 31,<br>2004              | As of<br>December 31,<br>2005 | Year ended<br>December 31,<br>2004                               | Year ended<br>December 31,<br>2005 |
| <b>(Local Currency units for 1 Euro)</b> |  |                               |  |                                    |
| <b>Europe</b>                            |  |                               |  |                                    |
| CHF Swiss Franc                          | 1.54290                                    | 1.55510                       | 1.54382  | 1.54822                            |
| GBP Pound Sterling                       | 0.70505                                    | 0.68530                       | 0.67867  | 0.68379                            |
| TRY Turkish Lira (*)                     | 1.82680                                    | 1.58750                       | 1.76698  | 1.67000                            |
| <b>North America</b>                     |  |                               |  |                                    |
| CAD Canadian Dollar                      | 1.64160                                    | 1.37250                       | 1.61675  | 1.50924                            |
| USD U.S. Dollar                          | 1.36210                                    | 1.17970                       | 1.24390  | 1.24436                            |
| <b>Central and South America</b>         |  |                               |  |                                    |
| VEB Venezuelan Bolivar (*)               | 2,615.23200                                | 2,536.35500                   | 2,321.68959  | 2,628.83494                        |
| BOB Bolivian                             | 10.92677                                   | 9.37862                       | 9.85905  | 9.99316                            |
| PEN Peruvian Nuevo Sol                   | 4.47041                                    | 4.05522                       | 4.24376  | 4.09907                            |
| ARS Argentine Peso                       | 4.05770                                    | 3.57685                       | 3.65974  | 3.63771                            |
| CLP Chilean Peso                         | 759.37075                                  | 604.59625                     | 757.93009  | 695.98714                          |
| COP Colombian Peso                       | 3,200.93500                                | 2,695.67349                   | 3,264.30912  | 2,886.68182                        |
| MXN Mexican Peso                         | 15.17924                                   | 12.58303                      | 14.03686   | 13.54809                           |
| BRL Brazilian Real                       | 3.61556                                    | 2.76132                       | 3.63932  | 3.02888                            |
| <b>Other countries</b>                   |  |                               |  |                                    |
| HKD Hong Kong Dollar                     | 10.58810                                   | 9.14740                       | 9.68811  | 9.67904                            |
| SGD Singapore Dollar                     | 2.22620                                    | 1.96280                       | 2.10156  | 2.07066                            |
| ILS Israeli Shekel                       | 5.87746                                    | 5.42426                       | 5.56705  | 5.57951                            |
| JPY Japanese Yen                         | 139.65000                                  | 138.90000                     | 134.44459  | 136.84625                          |

(\*) For the high-inflation countries (Turkey and Venezuela), the year-end exchange rates have been used to translate the statements of operations items.

(1) Source: Data processed by Central European Bank, Reuters and major Central Banks.

**d) Related Party Transactions**

Related party transactions, including intercompany intragroup transactions, are neither unusual nor exceptional but fall under the normal business operations of the companies of the Group. Such transactions, when not concluded at standard conditions or dictated by specific laws, are in any case conducted at arm's length.

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The economic, balance sheet and financial effects of related party transactions on the consolidated financial statements of the Telecom Italia Group at December 31, 2005 compared with those at December 31, 2004 are presented below.

The following table presents the major economic, balance sheet and financial transactions between companies consolidated line-by-line and associates.

| <b>Items</b>  | <b>Year ended December 31,</b> |             | <b>Nature of the transaction</b>   |
|---|--------------------------------|-------------|--|
|   | <b>2004</b>                    | <b>2005</b> |  |
| <i>Revenues</i>                                     | 320 million                    | 348 million | These mainly refer to revenues in respect of Teleleasing S.p.A. 230 million ( 200 million in 2004), LI.SIT. S.p.A. 68 million ( 50 million in 2004), Shared Service Center S.c.r.l. 22 million ( 32 million in 2004), Telecom Argentina S.A. 12 million ( 10 million in 2004), Golden Lines Ltd 3 million ( 10 million in 2004), ETECSA 6 million ( 9 million in 2004), AVEA I.H.A.S. 2 million ( 1 million in 2004) and NordCom S.p.A. 2 million.   |
| <i>Other income</i>                                 | 5 million                      | 6 million   | This mainly refers to cost recoveries for off-site personnel by certain subsidiaries and associates.   |
| <i>Purchases of materials and external services</i> | 409 million                    | 272 million | These refer mainly to costs for rent from Tiglio I S.r.l. 10 million ( 50 million in 2004), Tiglio II S.r.l. 12 million ( 26 million in 2004) and Telegono S.r.l. 1 million ( 1 million in 2004), for TLC services from ETECSA 90 million ( 123 million in 2004), Telecom Argentina S.A. 6 million ( 6 million in 2004), AVEA I.H.A.S. 3 million ( 1 million in 2004), for maintenance and assistance contracts from Shared Service Center S.c.r.l. 34 million ( 106 million in 2004), for software and computer materials and for maintenance and assistance contracts from Siemens Informatica S.p.A. 52 million ( 63 million in 2004), for TLC equipment from Teleleasing S.p.A. 23 million ( 15 million in 2004), sponsorship costs from Luna Rossa Challenge 2007 S.L. 17 million, costs for accessories and consumables from Baltea S.r.l. 3 million ( 4 million in 2004) and costs for remote medicine services from Telbios S.p.A. 3 million ( 1 million in 2004) and transport costs from Eurofly Service S.p.A. 3 million. |
| <i>Financial income</i>                             | 5million                       | 2 million   | This includes accrued interest income matured on loans made to certain associates.   |



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| Financial Statements   | Notes To Consolidated Financial Statements |             |  |
|--|--|-------------|--|
|  | Year ended December 31,                    |             |  |
| Items  | 2004                                       | 2005        | Nature of the transaction  |
| <i>Financial expenses</i>  | 60 million                                 | 32 million  | These mainly refer to interest expenses to Teleleasing S.p.A. 23 million ( 20 million in 2004) for finance leases and interest expenses to Tiglio I S.r.l. 4 million ( 29 million in 2004) and Tiglio II S.r.l. 4 million ( 10 million in 2004) for sale and leaseback transactions.   |
| <i>Capital expenditures in tangible and intangible assets</i>                | 71 million                                 | 147 million | These refer mainly to acquisitions of computer projects from Shared Service Center S.c.r.l. 84 million ( 21 million in 2004), Siemens Informatica S.p.A. 42 million ( 50 million in 2004) and Value Team S.p.A. 8 million.   |
|  | As of December 31,                         |             |  |
| Items  | 2004                                       | 2005        | Nature of the transaction  |
| <i>Securities and non-current financial receivables</i>                      | 28 million                                 | 24 million  | These refer mainly to medium/long term loans made to Aree Urbane S.r.l. 21 million ( 20 million at December 31, 2004) and Tiglio II S.r.l. 3 million ( 3 million at December 31, 2004). The decrease compared to December 31, 2004 is due to Golden Lines Ltd..  |
| <i>Miscellaneous receivables and other non-current assets</i>                | 36 million                                 | 15 million  | These refer to receivables from LI.SIT. S.p.A. 15 million for the residual additional paid-in capital paid ( 36 million at December 31, 2004).   |
| <i>Trade receivables, miscellaneous receivables and other current assets</i> | 190 million                                | 214 million | These refer mainly to receivables from LI.SIT. S.p.A. 102 million ( 79 million at December 31, 2004), Teleleasing S.p.A. 75 million ( 67 million at December 31, 2004), Shared Service Center S.c.r.l. 4 million ( 7 million at December 31, 2004), Telecom Argentina S.A. 4 million ( 8 million at December 31, 2004), AVEA I.H.A.S. 5 million ( 3 million at December 31, 2004), ETECSA 3 million ( 2 million at December 31, 2004), NordCom S.p.A. 1 million and Tiglio I S.r.l. 1 million ( 9 million at December 31, 2004). |

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| Financial Statements  | As of December 31, |             | Notes To Consolidated Financial Statements  |
|---|--------------------|-------------|---|
| Items   | 2004               | 2005        | Nature of the transaction   |
| <i>Financial receivables and other current financial assets</i>                                   | 32 million         |             | The reduction from December 31, 2004 is due to the repayment of the loans made to AVEA I.H.A.S. and Telegono S.r.l.   |
| <i>Cash and cash equivalents</i>  | 1 million          | 14 million  | These refer to treasury accounts with associates.   |
| <i>Non-current financial liabilities</i>  | 604 million        | 279 million | These refer to non-current financial payables for finance leases to Teleleasing S.p.A. 203 million ( 160 million at December 31, 2004), for sale and leaseback transactions to Tiglio I S.r.l. 43 million ( 329 million at December 31, 2004) and Tiglio II S.r.l. 33 million ( 112 million at December 31, 2004).  |
| <i>Miscellaneous payables and other non-current financial liabilities</i>                         | 5 million          | 10 million  | These refer to the medium/long-term portion of deferred income on the sale of IRU transmission capacity to Telecom Argentina S.A..  |
| <i>Current financial liabilities</i>  | 133 million        | 124 million | These refer to current financial payables for finance leases to Teleleasing S.p.A. 113 million ( 116 million at December 31, 2004), for sale and leaseback transactions to Tiglio I S.r.l. 8 million ( 11 million at December 31, 2004) and Tiglio II S.r.l. 3 million ( 4 million at December 31, 2004).   |
| <i>Trade payables, current tax payables, miscellaneous payables and other current liabilities</i> | 126 million        | 118 million | These mainly refer to payables for supply transactions connected with operations and investment activities with Siemens Informatica S.p.A. 56 million ( 61 million at December 31, 2004), Shared Service Center S.c.r.l. 18 million ( 34 million at December 31, 2004), LI.SIT. S.p.A. principally for the portion of deferred income from equity investments 11 million ( 2 million at December 31, 2004), Teleleasing S.p.A. 6 million ( 10 million at December 31, 2004), ETECSA 11 million ( 4 million at December 31, 2004), Tiglio I S.r.l. 2 million ( 2 million at December 31, 2004), Tiglio II S.r.l. 4 million ( 4 million at December 31, 2004), Telbios S.p.A. 2 million ( 1 million at December 31, 2004), Telecom Argentina S.A. 1 million, Baltea S.r.l. 1 million ( 1 million at December 31, 2004) and AVEA I.H.A.S. 1 million. |

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The Telecom Italia Group has also provided guarantees on behalf of associates for a total of 276 million ( 658 million at December 31, 2004) of which 121 million is on behalf of AVEA I.H.A.S. ( 454 million at December 31, 2004), 54 million on behalf of Tiglio I S.r.l. ( 56 million at December 31, 2004), 13 million on behalf of Tiglio II S.r.l. ( 13 million at December 31, 2004), 44 million on behalf of Aree Urbane S.r.l. ( 45 million at December 31, 2004) and 31 million on behalf of Italtel Holding S.p.A. ( 35 million at December 31, 2004).

In addition to transactions with associates, the following table presents transactions with companies controlled by associates. In 2005, these transactions refer to the companies of the Italtel Group, a related party through the investment in the parent, Italtel Holding S.p.A., and starting from July 1, 2005, the companies of the Brasil Telecom Participações S.A. group through Solpart Participações S.A..

| <b>Items</b>  | <b>Year ended December 31,</b> |             | <b>Nature of the transaction</b>  |
|---|--------------------------------|-------------|---|
|   | <b>2004</b>                    | <b>2005</b> |   |
| <i>Revenues</i>   | 3 million                      | 92 million  | These mainly refer to revenues for telecommunications services rendered to the Brasil Telecom Participações group 89 million.   |
| <i>Purchases of materials and external services</i>           | 23 million                     | 30 million  | These refer to costs for maintenance and assistance contracts from the Italtel group 20 million ( 23 million in 2004) and TLC service costs from the Brasil Telecom Participações group 10 million. |
| <i>Capital expenditures in tangible and intangible assets</i> | 324 million                    | 319 million | These refer to the purchase of telephone exchanges exclusively for the Italtel group.   |

| <b>Items</b>  | <b>As of December 31,</b> |             | <b>Nature of the transaction</b>   |
|---|---------------------------|-------------|--|
|   | <b>2004</b>               | <b>2005</b> |  |
| <i>Trade receivables, miscellaneous receivables and other current assets</i>                      | 2 million                 | 8 million   | These refer to telephone services rendered to the Italtel group 2 million ( 2 million at December 31, 2004) and receivables from the Brasil Telecom Participações group connected with TLC operations 4 million and dividends to be collected 2 million. |
| <i>Trade payables, current tax payables, miscellaneous payables and other current liabilities</i> | 150 million               | 101 million | These refer to supply transactions connected with investment and operating activities with the Italtel group 100 million ( 150 million at  |

December 31, 2004) and connected with TLC activities 1 million with the Brasil Telecom Participações group.

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The following table presents the major economic, balance sheet and financial transactions and balances between companies consolidated line-by-line and parties related to Telecom Italia through directors, statutory auditors and key managers of the Company.

| <b>Items</b>  | <b>Year ended December 31,</b> |             | <b>Nature of the transaction</b>   |
|---|--------------------------------|-------------|--|
|   | <b>2004</b>                    | <b>2005</b> |  |
| <i>Revenues</i>   | 40 million                     | 33 million  | These refer to information system and computer services and energy services supplied to the Pirelli group 3 million ( 5 million in 2004), and telephone services supplied to the Pirelli group 7 million ( 3 million in 2004), to the Edizione Holding group 4 million ( 5 million in 2004), to the Unipol group 16 million ( 13 million in 2004), to the ST Microelectronics group 1 million ( 2 million in 2004) and to related companies through Mr. Moratti 2 million ( 1 million in 2004). 2004 included 11 million of revenues with the Banca Intesa group and the Unicredito group which are no longer related parties.   |
| <i>Purchases of materials and external services</i>           | 120 million                    | 112 million | These refer to R&D expenditures and matters regarding intellectual property rights to the Pirelli group 72 million ( 86 million in 2004), Document management services from Telepost 21 million ( 15 million in 2004), insurance services from the Unipol group 10 million ( 11 million in 2004), sponsorship and content provider costs from F.C. Internazionale Milano S.p.A., a related company through Mr. Moratti, 5 million ( 5 million in 2004), commissions paid to Autogrill S.p.A (Edizione Holding group) for the sale of prepaid telephone cards 2 million ( 2 million in 2004) and the purchase of electronic components from ST Microelectronics 2 million ( 1 million in 2004). |
| <i>Other income</i>   | 1 million                      |             | These refer to miscellaneous revenues with the Pirelli group.  |
| <i>Other operating expenses</i>                               | 1 million                      |             | These refer to miscellaneous expenses with the Pirelli group.  |
| <i>Capital expenditures in tangible and intangible assets</i> | 24 million                     | 69 million  |  |

These mainly refer to purchases of cables, modems and ADSL equipment from the Pirelli group ( 24 million in 2004, principally in respect of TLC cable purchases).

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| Financial Statements  | As of December 31, |            | Notes To Consolidated Financial Statements   |
|---|--------------------|------------|--|
| Items   | 2004               | 2005       | Nature of the transaction  |
| <i>Trade receivables, miscellaneous receivables and other current assets</i>                      | 10 million         | 6 million  | These mainly refer to the above-mentioned services under revenues rendered to the Pirelli group 2 million ( 8 million at December 31, 2004), to the Edizione Holding group 2 million ( 2 million at December 31, 2004) and to other companies 2 million.   |
| <i>Trade payables, current tax payables, miscellaneous payables and other current liabilities</i> | 65 million         | 43 million | These mainly refer to supply transactions connected to the performance of services and investment activities with the Pirelli group 34 million ( 49 million at December 31, 2004), costs for Document Management services received from Telepost, 7 million ( 3 million at December 31, 2004), insurance costs to the Unipol group ( 11 million at December 31, 2004), and the purchase of electronic components from ST Microelectronics 1 million. |

Description of the main contracts between the Telecom Italia Group and associates, subsidiaries of associates and related parties through directors and key managers.

**Transactions with:**

*012 Golden Lines Int. Ltd*

Revenue related

With regard to transactions for international telecommunications services with other operators, the contracts refer to data transmission and voice services.

*AVEA I.H.A.S.*

Revenue related

The transactions refer to international telecommunications services, particularly roaming by AVEA I.H.A.S. customers on the Tim Italia network, technical assistance services rendered and the recovery of costs for Tim Italia staff on loan to AVEA I.H.A.S..

Expense related

The transactions refer to interconnection fees for roaming traffic by Tim Italia customers on the Avea network.

*Baltea S.p.A.*

Expense related

The transactions refer to purchases of accessories and consumable stores for Olivetti S.p.A. photocopiers destined for resale.

*ETECSA*

Revenue related

The transactions refer to international telecommunications services, particularly voice and data transmission traffic terminating in Italy and Telecom Italia Sparkle traffic in transit and Tim Italia roaming.

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Expense related

The contracts refer to the delivery of incoming international traffic to Cuba, prepaid by Telecom Italia Sparkle and by Telecom Italia San Marino, and roaming traffic originated by TIM customers on Cuba.

*Eurofly Service S.p.A.*

Expense related

The contract refers to the performance of non-scheduled air transport services to national and foreign destinations.

*LI.SIT. S.p.A.*

Revenue related

The contract provides for developing and implementing the computer and information network for the social health system of the Lombardy Region, making services available online to all the regional health structures by supplying:

- cards with microchips for all citizens and health operators in Lombardy;
- outsourcing services for the management of the Internet Data Center and hardware and software systems;
- professional and applications consulting for the implementation and management of the system.

*Luna Rossa Challenge 2007 S.L.*

Expense related

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The contracts refer to the sponsorship of the Luna Rossa sailboat during the XXXII America's Cup. According to these contracts Telecom Italia Group became the Main Sponsor of Luna Rossa and Partner and Official Sponsor of the race. It also acquired the sublicense rights on the Luna Rossa trademark for certain categories of goods.

*NordCom S.p.A.*

Revenue related

The transactions refer to the supply of data network connections and software applications.

Expense related

The contract refers to the development of systems and computer solutions.

*Shared Service Center S.c.a.r.l.*

Revenue related

The contracts provide for the supply of telephone and data transmission services as well as the operation of the client's software applications at the Telecom Italia data center.

Expense related

The contracts refer to the supply of computer and information services relating to:

- design, implementation, release, operation and management of portals, institutional sites, SAP and dedicated solutions;
- SAP application maintenance and service management services.

*Siemens Informatica S.p.A.*



Expense related

The contracts provide for the supply of software services to Group companies, as well as specific services, such as: Applications Management services, support services for the operation of Telecom Italia OSS systems, and support services for the computer technology distributed and applications software development and technical services for Tim Italia.

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*Telecom Argentina group*

Revenue related

The contracts refer to technical assistance provided by Telecom Italia for broadband development and technical assistance provided by Tim Italia for the study and implementation of Value Added Services, as well as data transmission and voice services as well as the supply of IRU transmission capacity by Telecom Italia Sparkle.

Expense related

Transactions relate to international telecommunications services.

*Teleleasing S.p.A.*

Revenue related

The transactions mainly arise from the application of the commercial cooperation agreement signed in 2000 between Telecom Italia and Teleleasing S.p.A., a company in the Mediobanca group. By virtue of this agreement, Telecom Italia offers customers the possibility of leasing telecommunications equipment. Teleleasing purchases the equipment from Telecom Italia and signs the leasing contract with the customer; Telecom Italia sees to the collection of lease payments after having acquired the rights.

Expense related

The contracts refer both to the lease of instrumental goods to Telecom Italia and its subsidiaries and the financial lease of a building.

*Tiglio I S.r.l.*

Expense related

The contracts refer to:

- the lease of buildings, premises also housing telecommunications equipment, with a term of 21 years and the possibility of tacit renewal, unless notice of termination is given by Telecom Italia, for successive periods of six years, at the same terms and conditions as originally agreed;
- the lease of buildings solely for office use, for standard lease periods.

*Tiglio II S.r.l.*

Expense related

The contracts refer to:

- the lease of buildings, premises also housing telecommunications equipment, with a term of 19 years and the possibility of tacit renewal, unless notice of termination is given, for successive periods of six years, at the same terms and conditions as originally agreed;
- the lease of buildings solely for office use, for standard lease periods.

*Telbios S.p.A.*

Expense related

The contracts refer to the supply of services, products and hardware systems and software under remote medicine plans.

*Telegono S.r.l.*

Expense related

This refers to one contract for the lease of a building solely for office use, for standard lease periods.

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*Brasil Telecom Participações group*

Revenue related

The transactions between the TIM Brasil group and the Brasil Telecom group refer exclusively to trading transactions which fall under the ordinary administration of the operations of the two telecommunication operators, which are regulated by market conditions normally defined and approved by the market regulatory agency. The revenue related contracts refer to telecommunications services, interconnection services in particular, and site sharing.

Expense related

These refer to telecommunications services, interconnection services in particular, site sharing and line leases.

*Italtel group*

Revenue related

The contracts provide for the supply of telephone and data transmission services.

Expense related

The contracts provide for the supply and maintenance of traditional switching and innovative switching (VoIP) and the relative services, as well as the supply of innovative devices and their maintenance for the data networks using CISCO technology.

*Edizione Holding group*

Revenue related

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The contracts provide for the supply of telephone and data transmission services that are operated by outsourcing with dedicated assistance.

Expense related

The transactions refer to commissions paid to Autogrill S.p.A. for the sale of prepaid telephone cards and occupancy charges for public telephones located at their structures.

*F.C. Internazionale Milano S.p.A.*

Expense related

The contracts refer to costs for the sponsorship and the rights to diffuse content regarding the sports events of the company F.C. Internazionale Milano by Telecom Italia and TIM.

*Pirelli & C. S.p.A.*

Revenue related

The contracts provide for the supply of telecommunications and computer and information services.

Expense related

The following contracts should be noted:

- *Consulting and services contract regarding patent rights*

In May 2002, a contract was signed with Pirelli under which services and consulting were rendered for:

- identification of a patent rights policy, by defining strategies which cater to business objectives, consistent for the entire Telecom Italia Group;



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- determination of the competitive positioning of the various businesses of the Telecom Italia Group in comparison with similar business of the competition;
  - assistance in negotiations over partnerships, licenses and cooperation contracts;
  - litigation and analyses of patents of the competition;
  - obtaining patents during each single stage (drawing up documents, filings in Italy and outside Italy, continuation during the stages of examination, challenges and conflicts);
  - control over costs by project and/or by business;
  - training of technicians;
  - insertion of patent data and relative reports using a database;
  - control over results reached;
  - patent research;
  - filing and classification of important documents regarding patents;
  - services and consulting regarding brands, including their management (research, filings in Italy and outside Italy, renewals, challenges, disputes, licenses inside and outside the Group).
- *Contract regarding research and development*

The contract refers to technical cooperation between Telecom Italia and Pirelli in the areas of optical devices and advanced telecommunications networks.

The contract provides:

- with regard to the results of research for which patents are not filed, three areas of competence which have been identified as follows:



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simple and complex devices, competence of Pirelli;

networks and services, competence of Telecom Italia;

subsystems, joint competence of Telecom Italia Pirelli;

- with regard to patents resulting from research, ownership is joint, with the understanding that each party must give the other a license on the respective portion of ownership according to the following plan:

Pirelli grants Telecom Italia an exclusive license which can be sublicensed for patents for use in the Networks and Services area;

Telecom Italia grants Pirelli an exclusive license which can be sublicensed for patents for use in the Devices area .

Each of the parties is required to pay the other party 50% of the consideration from any sublicenses granted.

Furthermore, Pirelli is obliged to sell, under an exclusive arrangement, to Telecom Italia and to companies which it controls, any optical devices for telecommunications that use patents deriving from the research projects, for a period of one year from the completion of the single project. However, the parties may agree upon alternative solutions which ensure a similar or substitute advantage to Telecom Italia.

- *Contracts for the supply of apparatus and cables*

These contracts provide for the supply of user apparatus for network access and broadband services, the supply of POTS Splitter (apparatus installed in the exchange which allow the combined transmission of voice and data on the same duplex cable) as well as supplying cables.

- *Cooperation agreement concerning joint initiatives in the field of recycling and the disposal of end-of-life products*

Under this contract, Pirelli has developed two research projects for Telecom Italia: one relating to the Distributed Sensor Network and the second to Third-generation poles for the wireline network . The

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agreements state that Telecom Italia is entitled to ownership of the rights to the intellectual properties deriving from the work established in the contracts where they are: a) exclusively applicable to telecommunications networks and/or telecommunications services or components of telecommunications networks which technical appendices of the projects identify as their specific objective, such as cards of the SIM-card type or network poles, and b) characterized by the inclusion of specific chemical compositions and/or treatments using specific chemical processes.

*Pirelli & C. Real Estate S.p.A.*

Revenue related

The contracts provide for the supply of call center services, data transmission services and electrical energy.

Expense related

The contracts refer to project management (realization of real estate projects), property management (administrative management of lease contracts) and agency (commercial management of owned and leased buildings).

Furthermore, Pirelli & C. Real Estate makes 35% investments in the capital of the companies which hold closed-end real estate investment funds to which the properties were contributed as part of the real estate transaction described in Item 4. Information on the Telecom Italia Group 4.5 Description of Property, Plants and Equipment the effects of which are disclosed in Note 8 Tangible Assets (owned and under finance leases) , and controls the management companies (Pirelli & C. Real Estate SGR and Pirelli & C. Real Estate SGR Opportunities) of the above real estate funds.

*ST Microelectronics group*

Revenue related

The contracts provide for the supply of telephone and data transmission services.

Expense related

The contracts provide for the supply of electronic components.

*Telepost S.p.A.*

Expense related

The contracts refer to the management of services connected with incoming and outgoing correspondence, outgoing correspondence generated on files with printing by a specialized center, management of the distribution of correspondence, management of the paper archives and management of all photocopy machines.

*Unipol group*

Revenue related

The contracts provide for the supply of telephone services that are operated by outsourcing with dedicated assistance and the sale of telecommunications equipment.

Expense related

The contracts refer to insurance policies for casualties (fire, liability to third-parties and accidents) and life insurance.

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Key executives, that is, those persons having authority and responsibility, directly or indirectly, for planning, management and control of the activities of Telecom Italia, including directors, are as follows:

| <b><u>Name</u></b>               | <b><u>Position</u></b>  |
|----------------------------------|---|
| <b><i>Directors</i></b>          |   |
| Marco Tronchetti Provera         | Chairman  |
| Carlo Orazio Buora               | Managing Director   |
| Riccardo Ruggiero                | Managing Director of Operations   |
|                                  | General Manager   |
| <b><i>Executive Officers</i></b> |   |
| Gustavo Bracco                   | Head of the Human Resources and Organization Group Function                               |
| Enrico Parazzini                 | Head of the Finance, Administration and Control Group Function                            |
|                                  | Head of the Media Business Unit   |
| Massimo Castelli                 | Managing Director of Telecom Italia Media S.p.A.<br>Chief Marketing Officer               |
| Francesco Chiappetta             | Head of Market Development in Operations<br>General Counsel                               |
| Luca Luciani                     | Head of the Corporate and Legal Affairs Group Function                                    |
| Stefano Pileri                   | Head of Sales in Operations<br>Chief Technology Officer                                   |
| Giuseppe Sala                    | Head of Technology in Operations<br>General Manager                                       |
| Germanio Spreafico               | Head of Top Client and Customer Services in Operations<br>Head of Purchasing Service Unit |

The total compensation paid by Telecom Italia or by companies controlled by the Group to key managers was 25 million, divided as follows:

|                              | <b>Year ended<br/>December 31,<br/>2005</b> |
|------------------------------|---|
|                              | <b>(millions of Euro)</b>                   |
| Short-term compensation      | 23  |
| Other long-term compensation | 2   |

**e) Stock Option Plans of the Telecom Italia Group**

Some listed companies of the Group have awarded forms of stock incentives to their employees (executives and middle management) using stock option plans.

At the end of 2005, the existing stock option plans relate to options which give the right to the subscription of Telecom Italia Ordinary Shares (including the options granted at the time by TIM S.p.A.) and Telecom Italia Media Ordinary Shares.

During 2005, the only new option grants refer to the Stock Option Plan of Telecom Italia Media S.p.A..

The stock option plans granted starting from January 1, 2005 are recognized in accordance with IFRS 2, *Share-Based Payment*. For the valuation of stock option plans, the Telecom Italia Group uses the binomial model Cox-Ross-Rubenstein (CRR) . This model calculates the possible values which the underlying stock can assume over the life of the option.

The stock option plans of the Group are described below.

***Telecom Italia S.p.A. Stock Option Plans***

With respect to the Telecom Italia stock option plans, account should be taken of the mergers that previously took place and which are described below:

- merger of Telecom Italia S.p.A. into Olivetti S.p.A.: starting from the date the merger came into effect (August 4, 2003), the holders of the options of the merged company and the merging company

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preserved the corresponding subscription rights. However, the number of shares that could originally be subscribed under the respective plans (one share for each option) was changed on the basis of the assignment ratio established for the shareholders of the two companies. In particular, each option of the pre-merger Telecom Italia S.p.A. stock option plans allowed the subscription of 3.300871 new post-merger Telecom Italia Ordinary Shares, whereas each option of the Olivetti S.p.A. stock option plans (which at December 31, 2005 are all terminated) allowed the subscription of 0.471553 post-merger new Telecom Italia new Ordinary Shares. Accordingly, the subscription price of each Telecom Italia Ordinary Share resulting from the exercise of the option was adjusted for each plan, dividing the exercise price of the options already determined by the respective assignment ratio;

- merger of TIM S.p.A. into Telecom Italia S.p.A.: starting from the date the merger came into effect (June 30, 2005), the holders of the options of the merged company preserved the corresponding subscription rights. However, the number of shares that could originally be subscribed under the TIM S.p.A. plans (one share for each option) was changed on the basis of the exchange ratio established for the shareholders of TIM S.p.A. Therefore, each option of the pre-merger TIM S.p.A. stock option plans allows the subscription of 1.73 post-merger Telecom Italia Ordinary Shares. Accordingly, the subscription price of each Telecom Italia Ordinary Share resulting from the exercise of the options was adjusted for each plan, dividing the exercise price of the options already determined by the exchange ratio.

In describing the stock option plans, for the purpose of rendering the representation of the options homogeneous with that of the underlying subscribable shares to which they correspond, and to facilitate their measurement on the basis of the relative subscription prices, the Group has used the concept of equivalent options. Equivalent options mean a quantity of options equal to those that would be necessary for the subscription of post-merger Telecom Italia Ordinary Shares to the extent of one share for each option exercised, or, more simply, a quantity of options equal to the number of Telecom Italia Ordinary Shares subscribable post-merger.

In this manner, the weighted average prices and the exercise prices indicated below, since they refer, depending on the cases, to the list prices of the assignable shares (eventually adjusted following the above mergers) or equivalent options, are consistent and directly comparable among each other.

The Telecom Italia stock option plans for the two-year period 2004 and 2005 are presented below.

- In the Olivetti S.p.A. meeting held on February 24, 2000, the Board of Directors resolved to introduce the Stock Option Plan 2002-2004, with 29,500,000 options granted at an exercise price which was originally equal to 3.705 for each option and, after the adjustment for the capital increases against payment made by Olivetti in 2001, to 3.308 for each option. Such options, following the merger of Telecom Italia S.p.A. into Olivetti S.p.A., correspond to 13,910,814 equivalent options at an exercise price of 7.015118 per equivalent option.

On February 9, 2001, 28,170,000 options of the Stock Option Plan 2002-2004 were cancelled after options were granted under the Stock Option Plan February 2002-December 2004 described below. The remaining 1,330,000 options, granted to managers who had terminated employment with Olivetti, remained outstanding.

At December 31, 2003, 800,000 options of the Stock Option Plan 2002-2004 were outstanding and corresponded to 377,241 equivalent options, at an exercise price equal to 7.015118 per equivalent option.

On December 15, 2004, the deadline for exercising the options expired and all the relative residual rights were forfeited. The plan was consequently terminated.

- In the meeting held on February 9, 2001, the Olivetti S.p.A. Board of Directors resolved to introduce the Stock Option Plan February 2002-December 2004 , with 29,000,000 options granted at an exercise price which was originally equal to 2.81 for each option and, after the adjustment for the capital increases against payment made by Olivetti in 2001, to 2.515 for each option. Such options, following the merger of Telecom Italia S.p.A. into Olivetti S.p.A., correspond to 13,675,037 equivalent options at an exercise price of 5.333441 per equivalent option.

The options of the Stock Option Plan February 2002-December 2004 were granted to replace the options in the Stock Option Plan 2002-2004 which, as described above, were cancelled on that date.

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At December 31, 2003, 5,940,000 options of the Stock Option Plan February 2002-December 2004 were outstanding, corresponding to 2,800,995 equivalent options, at an exercise price equal to 5.333441 per equivalent option.

On December 31, 2004, the deadline for exercising the options expired and all the relative residual rights were forfeited. The plan was consequently terminated.

- In the meetings held on October 28, 1999 and December 17, 1999, the Telecom Italia S.p.A. Board of Directors resolved to introduce the Stock Option Plan 1999, with 16,595,400 options granted to top management at an exercise price of Italian lire 13,150 per option (equal to 6.79). Such options, following the merger of Telecom Italia S.p.A. into Olivetti S.p.A., corresponded to 54,779,275 equivalent options, at an exercise price of 2.057033 per equivalent option.

The options were divided as follows:

a lot of 4,905,500 options, exercised by the end of 1999;

a lot of 5,754,900 options, which would have vested during the period January 2001 to December 2003, on condition that the average market price of Telecom Italia Ordinary Shares reached a pre-fixed performance parameter in December 2000;

a lot of 5,935,000 options, which would have vested during the period January 2002 to December 2004, on condition that the average market price of Telecom Italia Ordinary Shares reached a pre-fixed performance parameter in December 2001.

The performance parameters were both met and the options all were vested.

At December 31, 2003, 4,511,901 options of the Stock Option Plan 1999 were outstanding, corresponding to 14,893,133 equivalent options, at an exercise price equal to 2.057033 per equivalent option.

At December 31, 2004, the deadline for exercising the options of the last lot expired and the options of the Stock Option Plan 1999 were completely exercised. The plan was consequently terminated.

- In the meeting held on September 11, 2000, the Telecom Italia S.p.A. Board of Directors resolved to introduce the Stock Option Plan 2000, with 51,430,000 options granted at an exercise price of 13.815 per option. Such options, following the merger of Telecom Italia S.p.A. in Olivetti S.p.A., correspond to 169,763,796 equivalent options, at an exercise price of 4.185259 per equivalent option.



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The options were divided into three lots of 15,460,000 options each, vesting, respectively, in July 2001, 2002 and 2003 and an extraordinary fourth lot of 5,050,000 options vesting in July 2003. The Stock Option Plan 2000 provides for different expiration dates depending on the date the options vest: the first lot expires in July 2006, the second in June 2007, the third lot and the extraordinary lot in June 2008. For each of the first three lots, the options vested on condition that a performance parameter was met which was linked to the ratio of the arithmetic mean of the official market prices of Telecom Italia Ordinary Shares (considered over a specific period of time) to the arithmetic mean of the corresponding values of the Dow Jones Eurostoxx for the Telecommunications sector. The options of the extraordinary lot, instead, would have vested when the third lot vested only if, in addition to the conditions being met for the third lot, another performance parameter had been met which provided that the average price of Telecom Italia Ordinary Shares had not been lower than a specified minimum amount. If, in reference to one of the option lots, the performance criteria had not been met in a specific financial year, but were met during the course of the following year, then the options of that lot would be considered vested in that last year. The first and second lots met the performance criteria and, consequently, the options vested. The third lot and the extraordinary lot did not meet the performance criteria and, therefore, such options did not vest and were forfeit in 2003.

At December 31, 2005, the same as at December 31, 2004, 10,699,996 options of the Stock Option Plan 2000 were outstanding, corresponding to 35,319,216 equivalent options, at an exercise price equal to 4.185259 per equivalent option.

At the end of 2004 and 2005, the market price of Telecom Italia Ordinary Shares was lower than the exercise price per equivalent option.

- In the meeting held on July 27, 2001, the Telecom Italia S.p.A. Board of Directors resolved to introduce the Stock Option Plan 2001, with 67,025,000 options granted to managers and middle management

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of the Group at an exercise price of 10.488 per option. Such options, following the merger of Telecom Italia S.p.A. into Olivetti S.p.A., correspond to 221,240,879 equivalent options, at an exercise price of 3.177343 per equivalent option.

The options were divided into two lots of 33,512,500 options each, vesting, respectively, in April 2002 and 2003, expiring, respectively, in April 2007 and 2008. For each of the two lots, the options vested on condition that a performance parameter was met which was linked to the ratio of the arithmetic mean of the official market prices of Telecom Italia Ordinary Shares (considered over a specific period of time) to the arithmetic mean of the corresponding values of the Dow Jones Eurostoxx for the Telecommunications sector. The first lot met the performance criteria and, consequently, the options vested. The second lot, instead, did not meet the performance criteria and, therefore, such options did not vest and were forfeit in 2003.

At the beginning of 2005, 31,895,000 options of the Stock Option Plan 2001 were outstanding. During 2005, the rights to 32,500 options lapsed due to the termination of employment. At the end of 2005, 31,862,500 options are outstanding, corresponding to 105,173,383 equivalent options, at an exercise price equal to 3.177343 per equivalent option.

At the end of 2004 and 2005, the market value of Telecom Italia Ordinary Shares was lower than the exercise price per equivalent option.

- In the meeting held on February 13, 2002, the Telecom Italia S.p.A. Board of Directors resolved to introduce the Stock Option Plan 2002 Top , with 11,800,000 options granted to sixteen top managers of the Group at an exercise price of 9.203 per option. Such options, following the merger of Telecom Italia S.p.A., into Olivetti S.p.A. correspond to 38,950,278 equivalent options, at an exercise price of 2.788052 per equivalent option.

The options were divided into three lots, respectively, of 3,540,000, 3,540,000 and 4,720,000 options, vesting, respectively, in February 2003, 2004 and 2005 and expiring, respectively, in February 2008, 2009 and 2010. The Stock Option Plan 2002 Top could be exercised at the end of the vesting period and was not subject to performance parameters.

At the beginning of 2005, 10,500,000 options of Stock Option Plan 2002 Top are outstanding. During 2005, 810,885 options were exercised and the rights to 209,115 options lapsed due to the termination of employment. At December 31, 2005, 9,480,001.33 options are outstanding, corresponding to 31,292,243 equivalent options, at an exercise price equal to 2.788052 per equivalent option.

At the end of 2004, the market value of Telecom Italia Ordinary Shares was higher than the exercise price per equivalent option whereas at the end of 2005 it was lower.

- In the meeting held on March 26, 2002, the Telecom Italia S.p.A. Board of Directors considered the objective ineffectiveness of the Stock Option Plan 2000 as an incentive and as a means of retaining management loyalty, in relation to the exercise price of the options compared to the general market trend of the stock market. As a result, the Board resolved to introduce the Stock Option Plan 2002 , set aside for management of the Group who were already grantees of the Stock Option Plan 2000 and other managers hired after July 27, 2001 (starting date of the Stock Option

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Plan 2001). The grantees of the original Stock Option Plan 2000, on condition of voluntarily relinquishing the relative options, could take part in the new plan. The Stock Option Plan 2002 can be exercised at the end of the vesting period and is not subject to performance parameters.

The options were granted in March, in August and in October 2002. In particular, mention of the following should be made:

1. in March 2002, 29,958,000 options were granted at an exercise price of 9.665 per option. Such options, following the merger of Telecom Italia S.p.A. into Olivetti S.p.A., correspond to 98,887,493 equivalent options, at an exercise price of 2.928015 for each equivalent option.

The options were divided into three lots, respectively, of 8,987,400, 8,987,400 and 11,983,200 options, vesting, respectively, in March 2003, 2004 and 2005 and expiring, respectively, in March 2008, 2009 and 2010.

At the beginning of 2005, 22,412,501 options granted in March 2002 were outstanding. During 2005, 1,707,447 options were exercised and the rights to 800,000 options lapsed due to the

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termination of employment. At December 31, 2005, 19,905,053.50 options are outstanding, corresponding to 65,703,601 equivalent options, at an exercise price equal to 2.928015 per equivalent option.

At the end of 2004, the market value of Telecom Italia Ordinary Shares was higher than the exercise price per equivalent option whereas at the end of 2005 it was lower;

2. in August 2002, 840,000 options were granted at an exercise price of 7.952 per option. Such options, following the merger of Telecom Italia S.p.A. into Olivetti S.p.A., correspond to 2,772,723 equivalent options, at an exercise price equal to 2.409061 per equivalent option.

The options were divided into three lots, respectively, of 252,000, 252,000 and 336,000 options, vesting, respectively, in March 2003, 2004 and 2005 and expiring, respectively, in March 2008, 2009 and 2010.

At the beginning of 2005, 780,000 options granted in August 2002 were outstanding. During 2005, 61,000 options were exercised. At December 31, 2005, 719,000.43 options are outstanding, corresponding to 2,373,319 equivalent options, at an exercise price equal to 2.409061 per equivalent option.

At the end of 2004 and 2005, the market value of Telecom Italia Ordinary Shares was higher than the exercise price per equivalent option;

3. in October 2002, 200,000 options were granted at an exercise price of 7.721 per option. Such options, following the merger of Telecom Italia S.p.A. into Olivetti S.p.A., correspond to 660,173 equivalent options, at an exercise price equal to 2.339080 per equivalent option.

The options were divided into three lots, respectively, of 60,000, 60,000 and 80,000 options, vesting, respectively, in March 2003, 2004 and 2005 and expiring, respectively, in March 2008, 2009 and 2010.

At the beginning of 2005, 200,000 options granted in October 2002 were outstanding. During 2005, they were completely exercised. At December 31, 2005, therefore, there are no options of the Stock Option Plan 2002 granted in October 2002 outstanding at that date.

The stock option plans awarded at the time by TIM (pre-merger with Telecom Italia S.p.A.) and by TIM Hellas (sold in 2005) for the two-year period 2004-2005 are described below.

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- In the meeting held on December 22, 1999, the TIM S.p.A. Board of Directors resolved to introduce the Stock Option Plans 2000-2002 , with 21,210,000 options granted at an exercise price of 6.42 per option. Such options, following the merger of TIM S.p.A. into Telecom Italia S.p.A., correspond to 36,693,300 equivalent options, at an exercise price of 3.710983 per equivalent option.

The options were divided into three lots, respectively, of 6,999,300, 6,999,300 and 7,211,400 options, vesting, respectively in May 2000, June 2001 and 2002 and all expiring in December 2008. This date represents an extension of the original expiration date of December 31, 2005. The options can be exercised subject to reaching an objective minimum parameter to be measured with reference to the results achieved by the company in terms of E.V.A. (Economic Value Added), net of financial investments, compared to the minimum measurement indicated in the annual budget, respectively, in the years 1999, 2000 and 2001. The parameter was reached and, consequently, the options became exercisable in a continuing manner.

At the beginning of 2005, 12,302,319 options of the Stock Option Plans 2000-2002 were outstanding. During 2005, the rights to 566,666 options lapsed due to the termination of employment. At December 31, 2005, 11,735,653 options are outstanding, corresponding to 20,302,679 equivalent options, at an exercise price equal to 3.710983 per equivalent option.

At the end of 2004, the market value of TIM ordinary shares was lower than the exercise price per option and at the end of 2005, the market value of Telecom Italia Ordinary Shares was lower than the exercise price per equivalent option.

- In the meeting held on December 19, 2000, the TIM S.p.A. Board of Directors resolved to introduce the Stock Option Plans 2001-2003 , with 44,790,000 options granted at an exercise price of 8.671 per option. Such options, following the merger of TIM S.p.A. into Telecom Italia S.p.A., correspond to 77,486,700 equivalent options, at an exercise price of 5.012139 per equivalent option.

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The options were divided into three lots of 14,780,700, 14,780,700 and 15,228,600 options, vesting, respectively, in December 2001, 2002 and 2003 and all expiring in December 2005. For each of the three lots, the options can be exercised on condition that a performance parameter was met which was linked to the ratio of the arithmetic mean of the official market prices of TIM ordinary shares (considered over a specific period of time) to the arithmetic mean of the corresponding values of the Dow Jones Eurostoxx for the Telecommunications sector. All the lots met the performance criteria and, consequently, the options became exercisable. At the beginning of 2005, 1,190,000 options of the Stock Option Plans 2001-2003 were outstanding, corresponding to 2,058,700 equivalent options, at an exercise price equal to 5.012139 per equivalent option. On December 31, 2005, the deadline for exercising the options expired and all the relative residual rights are forfeited. The plans are consequently terminated.

- In the meeting held on May 10, 2001, the TIM S.p.A. Board of Directors resolved to supplement the Stock Option Plans 2001-2003 and to introduce the Supplementary Plans 2001-2003, with another 12,047,000 options granted at an exercise price of 7.526 per option. Such options, following the merger of TIM S.p.A. into Telecom Italia S.p.A., correspond to 20,841,310 equivalent options, at an exercise price of 4.350289 per equivalent option.

The options of the Supplementary Plans 2001-2003 had the same features and were subject to the same performance conditions as the Stock Option Plans 2001-2003 except for the different grant date.

The options were divided into three lots of 3,975,510, 3,975,510 and 4,095,980 options, vesting, respectively, in December 2001, 2002 and 2003 (only options which vested could be exercised also in the months of March, June, September and December in the years from 2002 to 2005 inclusive), all expiring in December 2005. All the lots met the performance criteria and, consequently, the options became exercisable.

At the beginning of 2005, 499,000 options of the Supplementary Plans 2001-2003 were outstanding, corresponding to 863,270 equivalent options, at an exercise price equal to 4.350289 per equivalent option. On December 31, 2005, the deadline for exercising the options expired and all the relative residual rights were forfeited. The plans are consequently terminated.

- In the meeting held on February 12, 2002, the TIM S.p.A. Board of Directors resolved to introduce the Stock Option Plans 2002-2003, with 25,510,000 options granted to managers and employees at an exercise price of 5.67 per option. Such options, following the merger of TIM S.p.A. into Telecom Italia S.p.A., correspond to 44,132,300 equivalent options, at an exercise price of 3.277457 per equivalent option.

The options were divided into two lots of 12,755,000 options each, vesting, respectively, in December 2002 and 2003 and all expiring in December 2008. The Stock Option Plans 2002-2003 could be exercised at the end of the vesting period and were not subject to performance parameters.

At the beginning of 2005, 23,280,000 options of the Stock Option Plans 2002-2003 were outstanding. During 2005, the rights to 1,255,000 options lapsed due to the termination of employment. At the end of 2005, 22,025,000 options are outstanding, corresponding to 38,103,250 equivalent options, at an exercise price equal to 3.277457 per equivalent option.

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At the end of 2004, the market value of TIM ordinary shares was lower than the exercise price per option and at the end of 2005 the market value of Telecom Italia Ordinary Shares was lower than the exercise price per equivalent option.

- In the meeting held on May 6, 2002, the TIM S.p.A. Board of Directors resolved to introduce the Stock Option Plans 2003-2005 set aside for management of the Group who already held options in the Stock Option Plans 2001-2003 and Supplementary Plans 2001-2003 and new grantees. The grantees who already held options in the previous plans could take advantage of the new plans, on condition of voluntarily relinquishing the relative options beforehand. The Stock Option Plans 2003-2005 provide for 50,057,000 options to be granted at an exercise price equal to 5.07 per option. Such options, following the merger of TIM S.p.A. into Telecom Italia S.p.A., correspond to 86,598,610 equivalent options, at an exercise price of 2.930636 per equivalent option. Of the total options, 48,142,000 were granted to grantees of the previous plans and 1,915,000 were granted to new grantees.

The options were divided into three lots, respectively, of 16,518,810, 16,518,810 and 17,019,380 options, vesting, respectively, in May 2003, May 2004 and December 2004 and expiring, respectively, in

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December 2008, 2009 and 2010. The Stock Option Plans 2003-2005 could be exercised at the end of the vesting period and were not subject to performance parameters.

At the beginning of 2005, 7,861,000 options of the Stock Option Plans 2003-2005 were outstanding, corresponding to 13,599,530 equivalent options. During 2005, 5,945,100 options, corresponding to 10,285,023 equivalent options, were exercised. At the end of 2005, 1,915,900 options are outstanding, corresponding to 3,314,507 equivalent options, at an exercise price equal to 2.930636 per equivalent option.

At the end of 2004, the market value of TIM ordinary shares was higher than the exercise price per option and at the end of 2005, the market value of Telecom Italia Ordinary Shares was lower than the exercise price per equivalent option.

- With reference to TIM Hellas, during 2004, 100,000 new options were granted and exercised together with 583,500 options previously issued. Furthermore, during 2004, 114,500 options previously issued had expired. Therefore, at the end of 2004, all the TIM Hellas plans had ceased to exist.

Movements in the TIM and TIM Hellas stock option plans for the period January 1, 2004 to June 30, 2005, effective date of the merger of TIM into Telecom Italia are presented in the following table.

|   | <b>Number of<br/>options</b> | <b>Weighted<br/>Average<br/>price per<br/>option</b> |
|---|------------------------------|--|
|   |                              | (Euro)   |
| <b>Options outstanding at December 31, 2003</b>           | <b>85,516,318</b>            | <b>5.54</b>  |
| Exercised   | (37,536,700)                 | 5.16   |
| Granted   | 100,000                      | 10.24  |
| Expired and Forfeited(1)                                  | (2,947,299)                  | 5.56   |
| <b>Options outstanding at December 31, 2004</b>           | <b>45,132,319</b>            | <b>5.87</b>  |
| Exercised   | (5,945,100)                  | 5.07   |
| Lapsed(2)   | (1,136,666)                  | 5.90   |
| <b>Options outstanding at June 30, 2005</b>               | <b>38,050,553</b>            | <b>5.99</b>  |
| <b>Equivalent options outstanding at June 30, 2005(3)</b> | <b>65,827,457</b>            | <b>3.46</b>  |

(1) These options expired since they were not exercised during the stated period or were forfeited as they did not become vested due to failure to reach the performance parameters.

(2)



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These options lapsed since they could no longer be exercised as a result of the termination of employment and/or other reasons (e.g. relinquished by the interested party).

- (3) Equivalent number of options and relative weighted average price deriving from the application of the TIM-Telecom Italia conversion ratio equal to 1.73.

The following table presents, with reference to the TIM stock option plans outstanding at December 31, 2004, grouped by the range of the exercise price, the residual weighted average life and the weighted average price of the option grants:

| Range of Grant Prices<br><br>(Euro) | Options Outstanding at<br>December 31, 2004 |  |   | Equivalent Options<br>Exercisable at<br>December 31, 2004 |   |
|-------------------------------------|---|--|---|---|---|
|                                     | Options                                     | Residual<br>Weighted<br>Average<br>Life<br><br>(years) | Weighted<br>Average<br>Grant<br>Price<br><br>(Euro) | Options   | Weighted<br>Average<br>Grant<br>Price<br><br>(Euro) |
| 5.07-5.67                           | 31,141,000                                  | 4.09   | 5.52  | 31,141,000  | 5.52  |
| 6.42-8.67                           | 13,991,319                                  | 3.64   | 6.65  | 13,991,319  | 6.65  |
|                                     | <b>45,132,319</b>                           |  |   | <b>45,132,319</b>   |   |

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Movements in all the Telecom Italia stock option plans for the year 2004 and 2005 (including plans granted by TIM S.p.A.) are presented below:

|   | Number of<br>equivalent<br>options | Weighted<br>Average<br>price per<br>equivalent<br>option<br><br>(Euro) |
|---|------------------------------------|--|
| <b>Options outstanding at December 31, 2003</b>                 | <b>284,339,845</b>                 | <b>3.14</b>  |
| Lapsed on January 1, 2004                                       | (1,788,412)                        | 2.93   |
| Exercised   | (18,057,012)                       | 2.18   |
| Expired and forfeited(1)  | (11,264,330)                       | 3.69   |
| <b>Options outstanding at December 31, 2004</b>                 | <b>253,230,091</b>                 | <b>3.18</b>  |
| Lapsed on January 1, 2005                                       | (755,890)                          | 3.02   |
| Exercised   | (9,174,215)                        | 2.83   |
| Lapsed(2)   | (4,623,274)                        | 3.04   |
| Expired and Forfeited   | (2,921,970)                        | 4.82   |
| Equivalent options coming from the merged company TIM S.p.A.(3) | 65,827,456                         | 3.46   |
| <b>Options outstanding at December 31, 2005</b>                 | <b>301,582,198</b>                 | <b>3.24</b>  |

(1) These equivalent options expired since they were not exercised during the stated period or were forfeited as they did not become vested due to failure to reach the performance parameters.

(2) These equivalent options lapsed since they could no longer be exercised as a result of the termination of employment and/or other reasons (e.g. relinquished by the interested party).

(3) Equivalent number of options resulting from the merged company TIM S.p.A. outstanding at June 30, 2005 (effective date of the merger with Telecom Italia S.p.A.). Additional details are provided in the pre-merger TIM stock options plans.

The following tables present, with reference to the Telecom Italia stock option plans outstanding at December 31, 2005 and 2004, grouped by the range of the exercise price, the residual weighted average life and the weighted average price of the option grants:

| Range of Grant Prices | Equivalent Options Outstanding at<br>December 31, 2005 |   |                                       | Equivalent Options<br>Exercisable at<br>December 31, 2005 |                                       |
|-----------------------|--|---|---------------------------------------|---|---------------------------------------|
|                       | Equivalent<br>Options                                  | Residual<br>Weighted<br>Average<br>Life | Weighted<br>Average<br>Grant<br>Price | Equivalent<br>Options                                     | Weighted<br>Average<br>Grant<br>Price |

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|           | (Euro) |                    | (years) | (Euro) |                    | (Euro) |
|-----------|--------|--------------------|---------|--------|--------------------|--------|
| 2.41      |        | 2,373,319          | 3.30    | 2.41   | 2,373,319          | 2.41   |
| 2.78-2.94 |        | 100,310,351        | 3.34    | 2.88   | 100,310,351        | 2.88   |
| 3.17-3.72 |        | 163,579,312        | 1.90    | 3.27   | 163,579,312        | 3.27   |
| 4.18-5.01 |        | 35,319,216         | 1.00    | 4.19   | 35,319,216         | 4.19   |
|           |        | <b>301,582,198</b> |         |        | <b>301,582,198</b> |        |

| Range of Grant Prices | Equivalent Options Outstanding at<br>December 31, 2004 |   |                                       | Equivalent Options<br>Exercisable at<br>December 31, 2004 |                                       |
|-----------------------|--|---|---------------------------------------|---|---------------------------------------|
|                       | Equivalent<br>Options                                  | Residual<br>Weighted<br>Average<br>Life | Weighted<br>Average<br>Grant<br>Price | Equivalent<br>Options                                     | Weighted<br>Average<br>Grant<br>Price |
| (Euro)                |  | (years)                                 | (Euro)                                |   | (Euro)                                |
| 2.34-2.41             | 3,234,844  | 4.31                                    | 2.39                                  | 1,861,686   | 2.39                                  |
| 2.79-2.93             | 109,114,801  | 4.26                                    | 2.88                                  | 65,280,732  | 2.89                                  |
| 3.18-4.19             | 140,880,446  | 2.22                                    | 3.43                                  | 140,880,446   | 3.43                                  |
|                       | <b>253,230,091</b>                                     |   |                                       | <b>208,022,864</b>  |                                       |

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***Telecom Italia Media S.p.A. Stock Option Plans***

All the options in the stock option plans of Telecom Italia Media give the right to subscribe to a number of Telecom Italia Media ordinary shares equal to the number of options exercised, at a specific exercise price.

The Telecom Italia Media stock option plans for the two-year period 2004 and 2005 are presented below.

- In the meeting held on January 25, 2001, the Telecom Italia Media S.p.A. (formerly Seat S.p.A.) Board of Directors resolved to introduce the Stock Option Plan 2000-2002, with 26,687,334 options granted at an exercise price of 1.220.

The options were divided into three lots, respectively, of 14,678,034, 6,004,650 and 6,004,650 options, vesting, respectively, in May 2001, 2002 and 2003 and expiring, respectively, in April 2004, 2005 and 2006.

At December 31, 2004, 940,313 options of the Stock Option Plan 2000-2002 were outstanding. During 2005, the following changes took place: 428,210 options were relinquished by the grantees in order to participate in the Plan 2005, the rights relating to 278,030 options lapsed due to the termination of employment and the date expired for the exercise of the remaining 234,073 options. At December 31, 2005, therefore, there are no longer any options outstanding.

- In the meeting held on May 17, 2002, the Telecom Italia Media S.p.A. (formerly Seat S.p.A.) Board of Directors resolved to introduce the Key People Plan, with 46,400,000 options granted at an exercise price of 0.8532.

The options were divided into three lots, respectively, of 13,920,000, of 13,920,000 and 18,560,000 options, vesting, respectively, in May 2003, 2004 and 2005 and all expiring in May 2008.

At December 31, 2004, 14,900,000 options of the Key People Plan were outstanding. During 2005, the following changes took place: 11,350,000 options were relinquished by the grantees in order to participate in the Plan 2005, the rights relating to 1,300,000 options lapsed due to the termination of employment. At December 31, 2005, 2,250,000 options are outstanding.

At the end of 2004 and 2005, the market value of Telecom Italia Media ordinary shares was lower than the exercise price.

- In the meeting held on February 23, 2005, the Telecom Italia Media S.p.A. Board of Directors resolved to introduce the Plan 2005, set aside for employees in service at Telecom Italia Media and its subsidiaries, identified on the basis of their specific responsibilities and/or expertise who were already grantees of the Stock Option Plan 2000-2002 and the Key People Plan. The grantees of the previous plans, on condition of voluntarily relinquishing the relative options beforehand, could take part in the new plan. The previous plans, however, remain in place at the same conditions, procedures and

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regulations for the employee grantees of the other Companies of the Telecom Italia Group, for retired employees and for employees of the Media Business Unit who did not relinquish the options.

Under the Plan 2005, 39,725,000 options were granted at an exercise price of 0.3826.

The options are divided into three lots, respectively of 15,890,000, 11,917,500 and 11,917,500 options, vesting, respectively, in July 2005, January 2006 and January 2007 and all expiring in December 2008.

During 2005, 11,005,170 options were exercised and 3,465,000 lapsed due to the termination of employment. At December 31, 2005, the total number of options outstanding is 25,254,830. At the end of 2005, the market value of Telecom Italia Media ordinary shares was higher than the exercise price.

On February 23, 2005, at the same time the options relating to the Plan 2005 were granted, the fair value of these options was determined, using the binomial CRR model on the basis of the following variables:

- average price of the share resulting from the exercise of the options: 0.3826 (average of the official market prices of Telecom Italia Media ordinary shares from January 23, 2005 to February 23, 2005 opening and closing dates included);
- exercise price: equal to the price of the share resulting from the exercise of the options ( 0.3826);
- volatility: at the date of valuation, the historical volatility of the stock of 37.30% was used;

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- option period: 3.85 years (from February 23, 2005 to December 31, 2008), corresponding to the end of the life of the option;
- expected dividend yield: zero, on the basis of the consideration that Telecom Italia Media up to February 23, 2005 has never paid out dividends;
- risk-free interest rate: the rate on Italian Government securities (BTP) was considered, interpolated at the expiration date of the option: December 31, 2008. Therefore, a rate of 2.82% was applied.

The fair value was determined as 0.1246 per option.

Movements in the Telecom Italia Media stock option plans for the years 2004 and 2005 are presented in the following table.

|   | Number of<br>options | Weighted<br>Average price<br>per option |
|---|----------------------|---|
|   |                      | (Euro)                                  |
| <b>Options outstanding at December 31, 2003</b> | <b>20,119,299</b>    | <b>0.91</b>                             |
| Expired(1) and Lapsed(2)                        | (4,278,986)          | 1.06                                    |
| <b>Options outstanding at December 31, 2004</b> | <b>15,840,313</b>    | <b>0.87</b>                             |
| Granted   | 39,725,000           | 0.38                                    |
| Exercised                                       | (11,005,170)         | 0.38                                    |
| Expired and Forfeited(1)                        | (234,073)            | 1.22                                    |
| Lapsed(2)                                       | (16,821,240)         | 0.77                                    |
| <b>Options outstanding at December 31, 2005</b> | <b>27,504,830</b>    | <b>0.42</b>                             |

(1) These equivalent options expired since they were not exercised during the stated period or were forfeited as they did not become vested due to failure to reach the performance parameters.

(2) These equivalent options lapsed since they could no longer be exercised as a result of the termination of employment and/or for other reasons (e.g. relinquished by the interested party).

The following tables present, with reference to the stock option plans outstanding at December 31, 2005 and 2004, grouped by the range of the exercise price, the residual weighted average life and the weighted average price of the option grants:

**Range of Grant Prices****Options Outstanding at****Options Exercisable at****December 31, 2005****December 31, 2005**

|        | Options           | Residual<br>Weighted<br>Average<br>Life | Weighted<br>Average<br>Grant<br>Price | Options          | Weighted<br>Average<br>Grant<br>Price |
|--------|-------------------|---|---------------------------------------|------------------|---------------------------------------|
| (Euro) |                   | (years)                                 | (Euro)                                |                  | (Euro)                                |
| 0.38   | 25,254,830        | 3.00                                    | 0.38                                  | 4,044,830        | 0.38                                  |
| 0.85   | 2,250,000         | 2.42                                    | 0.85                                  | 2,250,000        | 0.85                                  |
|        | <b>27,504,830</b> |   |                                       | <b>6,294,830</b> |                                       |

Of the 27,504,830 options outstanding at December 31, 2005, the number of options exercisable is 6,294,830. 50% of the remaining 21,210,000 options will become exercisable (10,605,000) on January 1, 2006 and the rest will become exercisable on January 1, 2007.

| Range of Grant Prices | Options Outstanding at<br>December 31, 2004 |   |                                       | Options Exercisable at<br>December 31, 2004 |                                       |
|-----------------------|---|---|---------------------------------------|---|---------------------------------------|
|                       | Options                                     | Residual<br>Weighted<br>Average<br>Life | Weighted<br>Average<br>Grant<br>Price | Options                                     | Weighted<br>Average<br>Grant<br>Price |
| (Euro)                |   | (years)                                 | (Euro)                                |   | (Euro)                                |
| 0.85                  | 14,900,000                                  | 3.43                                    | 0.85                                  | 8,940,000                                   | 0.85                                  |
| 1.22                  | 940,313                                     | 0.85                                    | 1.22                                  | 940,313                                     | 1.22                                  |
|                       | <b>15,840,313</b>                           |   |                                       | <b>9,880,313</b>                            |                                       |

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During the year 2005, research and development activities at Telecom Italia Group were mainly carried out by the Innovation & Engineering Services function (formerly Telecom Italia Lab) under Operations in collaboration with Pirelli Labs, and by Olivetti S.p.A..

Total costs incurred in 2005 amounted to approximately 180 million ( 181 million in the prior year) include external costs, labor costs of dedicated staff and depreciation and amortization.

Such costs were incurred mainly by the Wireline and Mobile Business Units. The research activities expensed during the year amount to 128 million ( 144 million in 2004). The development activities, which were made available for use during the year, were capitalized to the network or to software costs for an amount equal to 52 million ( 37 million in 2004).

Research and development activities conducted by the Telecom Italia Group are detailed in the Item 5. Operating and Financial Review and Prospects 5.7 Research, Development and Innovation .

**g) Operating leases****1) Revenue-related**

The Group has signed lease contracts for direct connections, in particular numeric and analog lines, offered under wholesale plans to interconnecting operators. At December 31, 2005, the amount of lease installments receivable on non-cancelable lease contracts is the following:

|                   | <b>Operating<br/>lease<br/>payments<br/>receivable</b> |
|-------------------|--|
|                   | <b>(millions<br/>of Euro)</b>                          |
| Within 1 year     | 152  |
| From 2 to 5 years | 88   |
| Beyond 5 years    |  |
| <b>Total</b>      | <b>240</b>   |



**2) Expense-related**

The Group has signed lease contracts for buildings (for periods from 6 to 9 years). At December 31, 2005, the amount of lease installments payable on non-cancelable lease contracts is the following:

|                   | <b>Operating<br/>lease<br/>payments<br/>payable</b> |
|-------------------|---|
|                   | <b>(millions<br/>of Euro)</b>                       |
| Within 1 year     | 233   |
| From 2 to 5 years | 716   |
| Beyond 5 years    | 311   |
| <b>Total</b>      | <b>1,260</b>  |

**NOTE 40 SUBSEQUENT EVENTS*****Sale of Corporacion Digital C.A.***

On January 19, 2006, Telecom Italia, through its subsidiary TIM International N.V., signed the agreement for the sale of the 100% interest in the Venezuelan mobile operator Corporacion Digital C.A. to Telvenco S.A., on the basis of an enterprise value of the company equal to U.S.\$425 million.

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The execution of the agreement is subject to the receipt of the necessary authorizations from the relevant Venezuelan authorities.

The sale will reduce the net financial debt of the Group by approximately U.S.\$425 million.

The sale of the investment in Corporacion Digitel C.A. falls under the strategy to rationalize the portfolio of international investments and focus the presence of the Telecom Italia Group in countries where it is possible to take better advantage of the potential to integrate the fixed and mobile platforms and where there is a national license.

***Agreement with Sky for Movie Channels on Alice Home TV***

On January 23, 2006, Telecom Italia and Sky signed an agreement for the marketing of the Sky movie channels on Alice Home TV , the TV via Internet owned by Telecom Italia, starting from February 2006.

The agreement allows Telecom Italia to broadcast Sky movie channels (Sky Cinema 1, Sky Cinema 2, Sky Cinema 3, Sky Cinema Autore, Sky Cinema Max, Sky Cinema 16:9, Sky Cinema Classics, Studio Universal and Rai Sat Cinema World) dedicated to the best national and international movies.

This agreement brings a broader range of films to Alice Home TV which already offers more than 400 movies on demand thanks to agreements reached with major Italian and foreign motion picture companies.

The movie package will be offered at a cost of 16 per month (inclusive of VAT) and can be purchased, not only when the request is made to activate Alice Home TV , but also through the TV by those who already have Telecom Italia's IPTV service.

Starting from February 2006, the Alice Home TV service, launched in 2005 in Bologna, Milan, Palermo and Rome was extended to a further 17 Italian cities (Alessandria, Bari, Biella, Brescia, Cagliari, Catania, Florence, Genoa, Modena, Naples, Padua, Reggio Emilia, Sondrio, Turin, Trieste, Venice and Verona), reaching about 4 million families.

***Repayment of Notes Telecom Italia Finance S.A.***

On January 3, 2006, Telecom Italia Finance S.A. repaid on maturity the Euro 1,100,000,000 Floating Rate Notes due 2006 issued by Telecom Italia Finance S.A. on May 29, 2002, indexed to the 3-month Euribor plus a spread of 1.25%, for a residual amount of 1,045.4 million.

***Early Repayment of Notes Telecom Italia S.p.A.***

On January 30, 2006, the first permissible date allowed by the bond indenture, the floating rate notes maturing October 29, 2007 denominated Telecom Italia S.p.A. euro 1,000,000,000 Floating Rate Notes due 2007 were repaid in advance, after the resolution passed by the Telecom Italia S.p.A. Board of Directors meeting held on December 21, 2005.

***Repurchase of Own Treasury Notes Telecom Italia Finance S.A.***

In January 2006, own bonds were repurchased by Telecom Italia Finance S.A. for 48 million out of the notes for 2,513 million, maturing April 20, 2006. The residual nominal debt is thus equal to 2,465 million.

In addition, notes convertible into Telecom Italia S.p.A. or Seat Pagine Gialle S.p.A. and Telecom Italia Media S.p.A. shares with a repayment premium, maturing March 15, 2006 were purchased for a nominal amount of 25 million ( 29 million is the repayment amount of the notes repurchased) and notes for 2,250 million, with coupon interest of 6.575%, maturing July 30, 2009 were repurchased for a nominal amount of 20 million. The residual nominal debt of those notes issues is thus equal to 1,710 million and 2,230 million, respectively.

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**NOTE 41 LIST OF COMPANIES OF THE TELECOM ITALIA GROUP****List of consolidated companies of the Telecom Italia Group included in the scope of consolidation**

| <b>Name</b>   | <b>Head Office</b>          | <b>Currency</b> | <b>Share Capital</b> | <b>% ownership</b> | <b>% of voting rights</b> | <b>Held by</b>  |
|---|-----------------------------|-----------------|----------------------|--------------------|---------------------------|---|
| <b>WIRELINE</b>   |                             |                 |                      |                    |                           |   |
| BBEYOND B.V.<br>(telecommunications services)   | AMSTERDAM<br>(HOLLAND)      | EUR             | 18,000               | 100.0000           |                           | BBNED N.V.  |
| BBNED N.V.<br>(telecommunications services)   | AMSTERDAM<br>(HOLLAND)      | EUR             | 82,430,000           | 99.9939            |                           | TELECOM ITALIA INTERNATIONAL N.V.   |
| ELETTRA TLC S.p.A.<br>(services rendered in connection with submarine cable systems for telecommunications) | ROME<br>(ITALY)             | EUR             | 10,329,200           | 70.0000            |                           | MEDITERRANEAN NAUTILUS S.A.   |
| EMAX TRADE S.r.l. (in liquidation)<br>(Internet site management)  | MILAN<br>(ITALY)            | EUR             | 100,000              | 100.0000           |                           | MATRIX SPA  |
| HANSENET TELEKOMMUNIKATION GmbH<br>(telecommunications services)  | HAMBURG<br><br>(GERMANY)    | EUR             | 91,521,500           | 100.0000           |                           | TELECOM ITALIA DEUTSCHLAND HOLDING GmbH   |
| INTERCALL S.A.<br>(sell of prepaid cards and audiotex services)   | PARIS<br>(FRANCE)           | EUR             | 807,060              | 88.6342            |                           | LIBERTY SURF GROUP S.A.   |
| LATIN AMERICAN NAUTILUS ARGENTINA S.A.<br>(installation and maintenance of submarine cable systems)         | BUENOS AIRES<br>(ARGENTINA) | ARS             | 2,000,000            | 99.9700            | 0.0300                    | LATIN AMERICAN NAUTILUS S.A.<br><br>LATIN AMERICAN NAUTILUS LTD                       |
| LATIN AMERICAN NAUTILUS BOLIVIA SRL<br>(installation and maintenance of submarine cable systems)            | LA PAZ<br><br>(BOLIVIA)     | BOB             | 6,730,600            | 99.9999            | 0.0001                    | LATIN AMERICAN NAUTILUS S.A.<br><br>LATIN AMERICAN NAUTILUS USA Inc.                  |
| LATIN AMERICAN NAUTILUS BRASIL Ltda<br>(installation and maintenance of submarine cable systems)            | RIO DE JANEIRO<br>(BRAZIL)  | BRL             | 105,353,711          | 99.9999            | 0.0001                    | LATIN AMERICAN NAUTILUS BRASIL PARTICIPACOES LTDA<br>LATIN AMERICAN NAUTILUS USA Inc. |
| LATIN AMERICAN NAUTILUS BRASIL PARTICIPACOES Ltda   | RIO DE JANEIRO<br>(BRAZIL)  | BRL             | 105,354,710          | 99.9999            | 0.0001                    | LATIN AMERICAN NAUTILUS S.A.<br><br>LATIN AMERICAN NAUTILUS LTD                       |

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(installation and maintenance of submarine cable systems)

|  |                             |     |               |                       |  |
|--|-----------------------------|-----|---------------|-----------------------|--|
| LATIN AMERICAN NAUTILUS CHILE S.A.<br>(installation and maintenance of submarine cable systems)    | SANTIAGO<br><br>(CHILE)     | CLP | 8,779,132,671 | 100.0000              | LATIN AMERICAN NAUTILUS S.A.   |
| LATIN AMERICAN NAUTILUS COLOMBIA Ltda<br>(installation and maintenance of submarine cable systems) | BOGOTA<br><br>(COLOMBIA)    | COP | 4,148,521,000 | 100.0000              | LATIN AMERICAN NAUTILUS S.A.   |
| LATIN AMERICAN NAUTILUS Ltd<br>(installation and maintenance of submarine cable systems)           | DUBLIN<br>(IRELAND)         | USD | 1,000,000     | 100.0000              | LATIN AMERICAN NAUTILUS S.A.   |
| LATIN AMERICAN NAUTILUS MEXICO S.A.<br>(installation and maintenance of submarine cable systems)   | MEXICO D.F.<br><br>(MEXICO) | MXN | 100,000       | 99.9900<br><br>0.0100 | LATIN AMERICAN NAUTILUS S.A.<br><br>LATIN AMERICAN NAUTILUS USA Inc. |
| LATIN AMERICAN NAUTILUS PANAMA S.A.<br>(installation and maintenance of submarine cable systems)   | PANAMA                      | USD | 10,000        | 100.0000              | LATIN AMERICAN NAUTILUS S.A.   |
| LATIN AMERICAN NAUTILUS PERU S.A.<br>(installation and maintenance of submarine cable systems)     | LIMA<br><br>(PERU)          | PEN | 43,374,195    | 100.0000              | LATIN AMERICAN NAUTILUS S.A.   |

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| Name  | Financial Statements   |          |               | Notes To Consolidated Financial Statements |                    |                                  |
|---|------------------------|----------|---------------|--|--------------------|----------------------------------|
|   | Head Office            | Currency | Share Capital | % ownership                                | % of voting rights | Held by                          |
| LATIN AMERICAN NAUTILUS S.A.<br>(holding company)   | LUXEMBOURG             | USD      | 55,500,000    | 100.0000                                   |                    | TELECOM ITALIA SPARKLE S.p.A.    |
| LATIN AMERICAN NAUTILUS SERVICE Inc.<br>(installation and maintenance of submarine cable systems)   | FLORIDA<br>(USA)       | USD      | 10,000        | 100.0000                                   |                    | LATIN AMERICAN NAUTILUS USA Inc. |
| LATIN AMERICAN NAUTILUS St. Croix LLC<br>(installation and maintenance of submarine cable systems)  | VIRGIN ISLES<br>(USA)  | USD      | 10,000        | 100.0000                                   |                    | LATIN AMERICAN NAUTILUS S.A.     |
| LATIN AMERICAN NAUTILUS USA Inc.<br>(installation and maintenance of submarine cable systems)   | FLORIDA<br>(USA)       | USD      | 20,000        | 100.0000                                   |                    | LATIN AMERICAN NAUTILUS S.A.     |
| LATIN AMERICAN NAUTILUS VENEZUELA C.A.<br>(installation and maintenance of submarine cable systems)   | CARACAS<br>(VENEZUELA) | VEB      | 43,425,000    | 100.0000                                   |                    | LATIN AMERICAN NAUTILUS S.A.     |
| LIBERTY SURF GROUP S.A.<br>(internet provider)  | PARIS<br>(FRANCE)      | EUR      | 282,559,451   | 100.0000                                   |                    | TELECOM ITALIA S.p.A.            |
| LIBERTY SURF NETWORK B.V.<br>(telephony services)   | AMSTERDAM<br>(HOLLAND) | EUR      | 20,001        | 100.0000                                   |                    | LIBERTY SURF GROUP S.A.          |
| LIBERTY SURF COMMUNICATIONS LTD (in liquidation)<br>(telephony services)  | LONDON<br>(UK)         | GBP      | 1,000         | 100.0000                                   |                    | LIBERTY TELECOM B.V.             |
| LIBERTY TELECOM B.V.<br>(wireline)  | AMSTERDAM<br>(HOLLAND) | EUR      | 3,871,142     | 100.0000                                   |                    | LIBERTY SURF NETWORK B.V.        |
| LOQUENDO SOCIETA PER AZIONI<br>(research, development and marketing of technologies and equipment regarding voice synthesis recognition and/or interaction) | TURIN<br>(ITALY)       | EUR      | 3,573,741     | 99.9846                                    |                    | TELECOM ITALIA S.p.A.            |
| MATRIX S.p.A.<br>(internet services)  | MILAN<br>(ITALY)       | EUR      | 1,100,000     | 100.0000                                   |                    | TELECOM ITALIA S.p.A.            |
| MED-1 (NETHERLANDS) B.V.<br>(holding company)   | AMSTERDAM<br>(HOLLAND) | EUR      | 18,151        | 100.0000                                   |                    | MED-1 SUBMARINE CABLES Ltd       |
| MED-1 ITALY S.r.l.  | ROME                   | EUR      | 548,477       | 100.0000                                   |                    | MED-1 (NETHERLANDS) B.V.         |

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(installation and management  
submarine cable systems in Italian  
seas)

(ITALY)

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|                            |          |     |            |         |                                  |
|----------------------------|----------|-----|------------|---------|----------------------------------|
| MED-1 SUBMARINE CABLES Ltd | TEL AVIV | NIS | 55,886,866 | 99.9123 | TELECOM ITALIA SPARKLE<br>S.p.A. |
|----------------------------|----------|-----|------------|---------|----------------------------------|

(installation and management of cable  
Lev)

(ISRAEL)

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|                           |           |     |        |          |                               |
|---------------------------|-----------|-----|--------|----------|-------------------------------|
| MEDITERRANEAN NAUTILUS BV | AMSTERDAM | EUR | 18,003 | 100.0000 | MEDITERRANEAN NAUTILUS<br>Ltd |
|---------------------------|-----------|-----|--------|----------|-------------------------------|

(holding company)

(HOLLAND)

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|                                      |                    |     |         |          |                              |
|--------------------------------------|--------------------|-----|---------|----------|------------------------------|
| MEDITERRANEAN NAUTILUS<br>GREECE Ltd | ATHENS<br>(GREECE) | EUR | 111,600 | 100.0000 | MEDITERRANEAN NAUTILUS<br>BV |
|--------------------------------------|--------------------|-----|---------|----------|------------------------------|

(installation and management of  
submarine cable systems)

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|                             |          |     |     |          |                              |
|-----------------------------|----------|-----|-----|----------|------------------------------|
| MEDITERRANEAN NAUTILUS Inc. | DELAWARE | USD | 500 | 100.0000 | MEDITERRANEAN NAUTILUS<br>BV |
|-----------------------------|----------|-----|-----|----------|------------------------------|

(telecommunications services)

(USA)

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|                                      |          |     |       |          |                              |
|--------------------------------------|----------|-----|-------|----------|------------------------------|
| MEDITERRANEAN NAUTILUS<br>ISRAEL Ltd | TEL AVIV | NIS | 1,000 | 100.0000 | MEDITERRANEAN NAUTILUS<br>BV |
|--------------------------------------|----------|-----|-------|----------|------------------------------|

(TLC services. installation and  
management of submarine cable  
systems)

(ISRAEL)

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|--|---------------------------|----------|---------------|---|--------------------|--|
| Name   | Head Office               | Currency | Share Capital | % ownership   | % of voting rights | Held by  |
| MEDITERRANEAN NAUTILUS ITALY S.p.A.<br>(installation and management of submarine cable systems)            | ROME<br>(ITALY)           | EUR      | 3,100,000     | 100.0000  |                    | MEDITERRANEAN NAUTILUS BV  |
| MEDITERRANEAN NAUTILUS Ltd<br>(installation and management of submarine cable systems)                     | DUBLIN<br>(IRELAND)       | USD      | 153,259       | 100.0000  |                    | MEDITERRANEAN NAUTILUS S.A.  |
| MEDITERRANEAN NAUTILUS S.A.<br>(holding company)   | LUXEMBOURG                | USD      | 118,000,000   | 99.9999<br>0.0001                                   |                    | TELECOM ITALIA SPARKLE S.p.A.<br>TELECOM ITALIA FINANCE S.A.   |
| MEDITERRANEAN NAUTILUS TELEKOMÜNİKASYON HİZMETLERİ TICARET ANONİM ŞİRKETİ<br>(telecommunications services) | ISTANBUL<br>(TURKEY)      | YTL      | 350,000       | 99.9988<br>0.0003<br><br>0.0003<br>0.0003<br>0.0003 |                    | MEDITERRANEAN NAUTILUS BV<br><br>MEDITERRANEAN NAUTILUS Ltd<br><br>MEDITERRANEAN NAUTILUS ITALY S.p.A.<br><br>MEDITERRANEAN NAUTILUS ISRAEL Ltd<br><br>MEDITERRANEAN NAUTILUS GREECE Ltd |
| NUOVA TIN.IT S.r.l.<br>(internet services)   | MILAN<br>(ITALY)          | EUR      | 10,000,000    | 100.0000  |                    | TELECOM ITALIA S.p.A.  |
| PATH.NET S.p.A.<br>(networking systems and telecommunications)   | ROME<br>(ITALY)           | EUR      | 25,800,000    | 100.0000  |                    | TELECOM ITALIA S.p.A.  |
| TELECOM ITALIA SAN MARINO S.p.A.<br>(telecommunications services in San Marino)                            | REPUBLIC OF<br>SAN MARINO | EUR      | 1,550,000     | 99.9999<br>0.0001                                   |                    | TELECOM ITALIA SPARKLE S.p.A.<br><br>TELECOM ITALIA S.p.A.   |
| TELECOM ITALIA DEUTSCHLAND HOLDING GmbH<br>(holding company)   | HAMBURG<br>(GERMANY)      | EUR      | 25,000        | 100.0000  |                    | TELECOM ITALIA S.p.A.  |
| TELECOM ITALIA NETHERLANDS B.V.<br>(telecommunications services)   | AMSTERDAM<br>(HOLLAND)    | EUR      | 18,200        | 100.0000  |                    | TELECOM ITALIA SPARKLE S.p.A.  |
| TELECOM ITALIA S.A.<br>(supply and internet access)  | PARIS<br>(FRANCE)         | EUR      | 3,478,234     | 100.0000  |                    | LIBERTY SURF GROUP S.A.  |



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|   |                               |     |             |                       |   |
|---|-------------------------------|-----|-------------|-----------------------|---|
| TELECOM ITALIA SPAIN SL<br>UNIPERSONAL (telecommunications<br>services)                             | MADRID<br><br>(SPAIN)         | EUR | 2,003,096   | 100.0000              | TELECOM ITALIA SPARKLE<br>S.p.A.  |
| TELECOM ITALIA SPARKLE OF<br>NORTH AMERICA INC.<br>(telecommunications and promotional<br>services) | NEW YORK<br><br>(USA)         | USD | 15,550,000  | 100.0000              | TELECOM ITALIA SPARKLE<br>S.p.A.  |
| TELECOM ITALIA SPARKLE S.p.A.<br>(public and private telecommunication<br>services management)      | ROME<br>(ITALY)               | EUR | 200,000,000 | 100.0000              | TELECOM ITALIA S.p.A.   |
| TELECOM ITALIA SPARKLE<br>SINGAPORE PTE. LTD<br>(telecommunications services)                       | SINGAPORE                     | USD | 500,000     | 99.9998<br><br>0.0002 | TELECOM ITALIA SPARKLE<br>S.p.A.<br>TELECOM ITALIA SPARKLE OF<br>NORTH AMERICA INC. |
| TELECOM MEDIA INTERNATIONAL<br>ITALY-CANADA INC. (in liquidation)<br>(telecommunications services)  | MONTREAL<br><br>(CANADA)      | CAD | 952,100     | 100.0000              | TMI TELEMEDIA<br>INTERNATIONAL LTD  |
| TELECONTACT CENTER S.p.A..<br>(telemarketing services)  | NAPLES<br>(ITALY)             | EUR | 770,000     | 100.0000              | TELECOM ITALIA S.p.A.   |
| TELEFONIA MOBILE SAMMARINESE<br>S.p.A..<br>(mobile telephony services)                              | REPUBLIC OF<br><br>SAN MARINO | EUR | 78,000      | 51.0000               | TELECOM ITALIA SAN MARINO<br>S.p.A.   |
| TELEMEDIA INTERNATIONAL USA<br>Inc.<br>(telecommunications services)                                | NEW JERSEY<br><br>(USA)       | USD | 154,022,889 | 100.0000              | TMI TELEMEDIA<br>INTERNATIONAL Ltd  |

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| Financial Statements  |                            |          |               | Notes To Consolidated Financial Statements |                    |   |
|---|----------------------------|----------|---------------|--|--------------------|---|
| Name  | Head Office                | Currency | Share Capital | % ownership                                | % of voting rights | Held by   |
| THINX-SM TELEHOUSE INTERNET EXCHANGE S.r.l.<br>(housing and hosting)  | REPUBLIC OF<br>SAN MARINO  | EUR      | 25,800        | 99.9999<br>0.0001                          |                    | TELECOM ITALIA SAN MARINO S.p.A.<br><br>TELECOM ITALIA SPARKLE S.p.A. |
| TI BELGIUM S.P.R.L. B.V.B.A.<br>(telecommunications services)   | BRUSSELS<br>(BELGIUM)      | EUR      | 3,000,000     | 99.9967                                    |                    | TELECOM ITALIA SPARKLE S.p.A..  |
| TI GERMANY GmbH<br>(telecommunications services)  | FRANKFURT<br>(GERMANY)     | EUR      | 25,000        | 100.0000                                   |                    | TELECOM ITALIA SPARKLE S.p.A..  |
| TI SWITZERLAND GmbH<br>(telecommunications services)  | ZURICH<br>(SWITZERLAND)    | CHF      | 2,000,000     | 100.0000                                   |                    | TELECOM ITALIA SPARKLE S.p.A..  |
| TI TELECOM ITALIA (AUSTRIA) TELEKOMMUNICATIONDIESTE GMBH<br>(telecommunications services)                                   | VIENNA<br>(AUSTRIA)        | EUR      | 2,735,000     | 100.0000                                   |                    | TELECOM ITALIA SPARKLE S.p.A.   |
| TI UNITED KINGDOM Ltd<br>(telecommunications services)  | LONDON<br>(UK)             | GBP      | 4,150,000     | 100.0000                                   |                    | TELECOM ITALIA SPARKLE S.p.A.   |
| TELECOM ITALIA SPARKLE FRANCE S.A.S.<br>(installation and maintenance of tlc services for wireline and afferent activities) | PUTEAUX<br>(FRANCE)        | EUR      | 3,295,000     | 100.0000                                   |                    | TELECOM ITALIA SPARKLE S.p.A.   |
| TMI TELEMEDIA INTERNATIONAL Ltd<br>(telecommunications services)  | LONDON<br>(UK)             | EUR      | 3,983,254     | 100.0000                                   |                    | TELECOM ITALIA SPARKLE S.p.A.   |
| TMI TELEMEDIA INTERNATIONAL DO BRASIL LTDA<br>(telecommunications services)   | SAO PAULO<br>(BRAZIL)      | BRL      | 2,589,317     | 100.0000                                   |                    | TMI TELEMEDIA INTERNATIONAL LTD                                       |
| <b>MOBILE</b>   |                            |          |               |  |                    |   |
| BLAH! INC<br>(mobile network services)  | FLORIDA<br>(USA)           | USD      | 23,464,000    | 100.0000                                   |                    | TIM INTERNATIONAL N.V.  |
| BLAH! SOCIEDADE ANÔNIMA DE SERVIÇOS E COMÉRCIO<br>(internet services)   | RIO DE JANEIRO<br>(BRAZIL) | BRL      | 92,383,315    | 100.0000                                   |                    | TIM CELULAR S.A.  |

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|  |                                     |     |                |          |         |  |
|--|-------------------------------------|-----|----------------|----------|---------|--|
| CRC Centro de Relacionamento com Clientes LTDA<br>(call center services)                         | SAO PAULO<br>(BRAZIL)               | BRL | 98,433,599     | 100.0000 |         | TIM CELULAR S.A.                         |
| MAXITEL S.A.<br>(mobile telephony operator)  | BELO HORIZONTE<br>(BRAZIL)          | BRL | 1,200,769,399  | 100.0000 |         | TIM CELULAR S.A.                         |
| TIM BRASIL SERVIÇOS E PARTICIPAÇÕES S.A.<br>(holding company)                                    | RIO DE JANEIRO<br>(BRAZIL)          | BRL | 10,948,214,541 | 100.0000 |         | TIM INTERNATIONAL N.V.                   |
| TIM CELULAR S.A. (mobile telephony operator)   | SAO PAULO<br>(BRAZIL)               | BRL | 10,135,186,929 | 100.0000 |         | TIM BRASIL SERVIÇOS E PARTICIPAÇÕES S.A. |
| TIM INTERNATIONAL N.V.<br>(holding company)  | AMSTERDAM<br>(HOLLAND)              | EUR | 555,431,000    | 100.0000 |         | TELECOM ITALIA S.p.A.                    |
| TIM ITALIA S.p.A.<br>(mobile telephony operator)   | MILAN<br>(ITALY)                    | EUR | 413,552,203    | 100.0000 |         | TELECOM ITALIA S.p.A.                    |
| TIM NORDESTE TELECOMUNICAÇÕES S.A.<br>(mobile telephony operator)                                | JABOATÃO DOS GUARARAPES<br>(BRAZIL) | BRL | 535,995,597    | 100.0000 |         | TIM PARTICIPAÇÕES S.A.                   |
| TIM PARTICIPACOES<br>(holding company for operating companies providing mobile network services) | RIO DE JANEIRO<br>(BRAZIL)          | BRL | 1,472,074,525  | 19.8798  | 50.3335 | TIM BRASIL SERVIÇOS E PARTICIPAÇÕES S.A. |
| TIM SUL S.A.<br>(mobile telephony operator)  | CURITIBA<br>(BRAZIL)                | BRL | 1,001,243,386  | 100.0000 |         | TIM PARTICIPAÇÕES S.A.                   |

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| Financial Statements  |               |          |                | Notes To Consolidated Financial Statements |                    |  |
|---|---------------|----------|----------------|--|--------------------|--|
| Name  | Head Office   | Currency | Share Capital  | % ownership                                | % of voting rights | Held by  |
| <b>MEDIA</b>  |               |          |                |  |                    |  |
| BEIGUA S.r.l.<br><br>(purchase, sale, management and maintenance of systems for the repair and distribution of radio and TV broadcasting)                       | ROME (ITALY)  | EUR      | 51,480         | 51.0004                                    |                    | TI MEDIA BROADCASTING S.r.l.                         |
| GIALLO VIAGGI.IT S.r.l. (in liquidation)<br><br>(research, design, development, production of information and telematic products for tourism)                   | MILAN (ITALY) | EUR      | 10,000         | 100.0000                                   |                    | TELECOM ITALIA MEDIA S.p.A.                          |
| HOLDING MEDIA E COMUNICAZIONE PUBBLICITA S.r.l. (in liquidation)<br><br>(purchase/sale of ad space and management of advertising on radio/TV stations/channels) | ROME (ITALY)  | EUR      | 10,000         | 100.0000                                   |                    | HOLDING MEDIA E COMUNICAZIONE HMC S.p.A.             |
| HOLDING MEDIA E COMUNICAZIONE H.M.C. S.p.A.<br><br>(production, marketing on TV and press)  | ROME (ITALY)  | EUR      | 5,064,000      | 100.0000                                   |                    | TELECOM ITALIA MEDIA S.p.A.                          |
| LA7 TELEVISIONI S.p.A.<br><br>(purchase, management and maintenance of technical transmission systems for audio and video broadcasting)                         | ROME (ITALY)  | EUR      | 6,200,000      | 100.0000                                   |                    | TELECOM ITALIA MEDIA S.p.A.                          |
| MTV ITALIA S.r.l.<br>(services in the field of radio and TV broadcasting, production and sale of radio, TV and cinema programs)                                 | ROME (ITALY)  | EUR      | 12,151,928     | 51.0000                                    |                    | LA7 TELEVISIONI S.p.A.                               |
| MTV PUBBLICITA S.r.l.<br>(advertising agency)   | MILAN (ITALY) | EUR      | 10,400         | 100.0000                                   |                    | MTV ITALIA S.r.l.                                    |
| SCS COMUNICAZIONE INTEGRATA S.p.A. (in liquidation)<br><br>(marketing and communication consulting)   | ROME (ITALY)  | EUR      | 600,000        | 100.0000                                   |                    | TELECOM ITALIA MEDIA S.p.A.                          |
| TELECOM ITALIA MEDIA S.p.A.   | ROME (ITALY)  | EUR      | 100,327,259.46 | 65.8300<br>2.2500                          | 66.9200<br>2.2900  | TELECOM ITALIA S.p.A.<br>TELECOM ITALIA FINANCE S.A. |

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(management of all activities connected  
with the handling of information)

|                           |                 |     |         |          |                             |
|---------------------------|-----------------|-----|---------|----------|-----------------------------|
| TELECOM MEDIA NEWS S.p.A. | ROME<br>(ITALY) | EUR | 120,000 | 100.0000 | TELECOM ITALIA MEDIA S.p.A. |
|---------------------------|-----------------|-----|---------|----------|-----------------------------|

(multimedia journalistic information)

|  |                 |     |            |          |                        |
|--|-----------------|-----|------------|----------|------------------------|
| TI MEDIA BROADCASTING S.r.l.<br>(purchase, sale, management and<br>maintenance of installation for the repair<br>and distribution of radio and TV<br>broadcasting) | ROME<br>(ITALY) | EUR | 10,034,532 | 100.0000 | LA7 TELEVISIONI S.p.A. |
|--|-----------------|-----|------------|----------|------------------------|

|                                 |                  |     |        |          |                             |
|---------------------------------|------------------|-----|--------|----------|-----------------------------|
| TIN WEB S.r.l. (in liquidation) | MILAN<br>(ITALY) | EUR | 10,000 | 100.0000 | TELECOM ITALIA MEDIA S.p.A. |
|---------------------------------|------------------|-----|--------|----------|-----------------------------|

(internet site development consulting)

**OLIVETTI**

|   |                 |     |        |                    |  |
|---|-----------------|-----|--------|--------------------|--|
| CONSORZIO MAEL<br>(participation in bids and competitions<br>held by public and private entities) | ROME<br>(ITALY) | EUR | 52,000 | 60.0000<br>40.0000 | OLIVETTI S.p.A.<br>TIEMME SISTEMI S.r.l. |
|---|-----------------|-----|--------|--------------------|--|

|   |                          |     |           |          |                         |
|---|--------------------------|-----|-----------|----------|-------------------------|
| DIASPRON DO BRASIL S.A. (in<br>liquidation) | SAO<br>PAULO<br>(BRAZIL) | BRL | 5,135,417 | 100.0000 | OLIVETTI DO BRASIL S.A. |
|---|--------------------------|-----|-----------|----------|-------------------------|

(manufacture and export of typewriters  
and printers)

|   |                    |     |           |          |                         |
|---|--------------------|-----|-----------|----------|-------------------------|
| MULTIDATA S/A ELETRONICA<br>INDUSTRIA E COMERCIO (in liquidation) | MANAUS<br>(BRAZIL) | BRL | 5,583,350 | 100.0000 | OLIVETTI DO BRASIL S.A. |
|---|--------------------|-----|-----------|----------|-------------------------|

(manufacture and export of typewriters  
and printers)

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| Financial Statements   |                               |          |               | Notes To Consolidated Financial Statements |                    |  |
|--|-------------------------------|----------|---------------|--|--------------------|--|
| Name   | Head Office                   | Currency | Share Capital | % ownership                                | % of voting rights | Held by  |
| OLIVETTI AUSTRIA Ges.m.b.H<br><br>(sale of office equipment and accessories)                                     | VIENNA<br><br>(AUSTRIA)       | EUR      | 36,336        | 100.0000                                   |                    | OLIVETTI INTERNATIONAL B.V.  |
| OLIVETTI FRANCE S.A.<br><br>(sale of office equipment and software)  | PUTEAUX<br><br>(FRANCE)       | EUR      | 2,200,000     | 100.0000                                   |                    | OLIVETTI INTERNATIONAL B.V.  |
| OLIVETTI INTERNATIONAL B.V.<br>(holding company)   | AMSTERDAM<br>(HOLLAND)        | EUR      | 355,027,092   | 100.0000                                   |                    | OLIVETTI S.p.A.  |
| OLIVETTI UK Ltd.<br><br>(sale of office equipment)   | MILTON KEYNES<br><br>(UK)     | GBP      | 6,295,712     | 100.0000                                   |                    | OLIVETTI INTERNATIONAL B.V.  |
| OLIVETTI ARGENTINA S.A.C.e.l. (in liquidation)<br><br>(sale and maintenance of office equipment)                 | BUENOS AIRES<br>(ARGENTINA)   | ARS      | 7,590,000     | 100.0000                                   |                    | OLIVETTI INTERNATIONAL B.V.  |
| OLIVETTI CHILE S.A. (in liquidation)<br><br>(sale and maintenance of office equipment, accessories and software) | SANTIAGO<br><br>(CHILE)       | CLP      | 2,574,015,843 | 99.9999<br>0.0001                          |                    | OLIVETTI INTERNATIONAL B.V.<br><br>OLIVETTI S.p.A.   |
| OLIVETTI COLOMBIANA S.A. (in liquidation)<br><br>(sale of office and industrial equipment)                       | BOGOTA<br><br>(COLOMBIA)      | COP      | 2,500,000,000 | 90.5200<br>9.4700<br>0.0001                |                    | OLIVETTI INTERNATIONAL B.V.<br><br>OLIVETTI S.p.A.<br><br>OLIVETTI CHILE<br><br>(in liquidation) |
| OLIVETTI DE PUERTO RICO, Inc.<br><br>(office equipment in the United States and Central America)                 | SAN JUAN<br><br>(PUERTO RICO) | USD      | 1,000         | 100.0000                                   |                    | OLIVETTI INTERNATIONAL B.V.  |
| OLIVETTI DEUTSCHLAND GmbH<br><br>(sale of office equipment and holding company)                                  | NURNBERG<br><br>(GERMANY)     | EUR      | 25,600,000    | 100.0000                                   |                    | OLIVETTI INTERNATIONAL B.V.  |
| OLIVETTI DO BRASIL S.A.  | SAO PAULO                     | BRL      | 111,660,625   | 96.6446<br>3.3554                          |                    | OLIVETTI INTERNATIONAL B.V.  |

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|   |                      |     |             |                       |  |  |
|---|----------------------|-----|-------------|-----------------------|--|--|
| (manufacture and sale of typewriters, accessories, parts and assistance)  | (BRAZIL)             |     |             |                       |  | OLIVETTI MEXICANA S.A. (in liquidation)            |
| OLIVETTI ENGINEERING S.A. (ex YMINDS)   | YVERDON LES BAINS    | CHF | 100,000     | 100.0000              |  | OLIVETTI I-JET S.p.A.                              |
| (product research and development based on ink-jet technology)  | (SWITZERLAND)        |     |             |                       |  |  |
| OLIVETTI I-JET S.p.A.<br>(manufacture and sale of products and accessories for office equipment)                            | ARNAD (AOSTA ITALY)  | EUR | 15,000,000  | 100.0000              |  | OLIVETTI S.p.A.                                    |
| OLIVETTI MEXICANA S.A. (in liquidation)   | MEXICO CITY (MEXICO) | MXN | 34,637,065  | 99.9999<br>0.0001     |  | OLIVETTI INTERNATIONAL B.V.<br><br>OLIVETTI S.p.A. |
| (manufacture and sale, import-export of typewriters, adding machines, accessories and parts, technical assistance services) |                      |     |             |                       |  |  |
| OLIVETTI S.p.A.<br>(manufacture and sale of products and accessories for office equipment)                                  | IVREA (TURIN ITALY)  | EUR | 128,000,000 | 100.0000              |  | TELECOM ITALIA S.p.A.                              |
| OLIVETTI TECNOST (H.K.) LTD (in liquidation)<br>(sale of equipment and systems in the Pacific area and other areas)         | HONG KONG            | HKD | 200,000     | 99.5000<br><br>0.5000 |  | OLIVETTI INTERNATIONAL B.V.<br><br>OLIVETTI S.p.A. |
| OLIVETTI TECNOST ESPANA S.A.  | BARCELONA (SPAIN)    | EUR | 1,229,309   | 99.9863               |  | OLIVETTI INTERNATIONAL B.V.                        |
| (sale and maintenance of office equipment, consulting and telematic network management)                                     |                      |     |             |                       |  |  |

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|--|-----------------------------|----------|---------------|--|--------------------|--|
| Name   | Head Office                 | Currency | Share Capital | % ownership                                | % of voting rights | Held by  |
| OLIVETTI TECNOST NEDERLAND B.V.<br>(sale of office equipment and accessories)  | LEIDERDORP<br>(HOLLAND)     | EUR      | 6,468,280     | 100.0000                                   |                    | OLIVETTI INTERNATIONAL B.V.  |
| OLIVETTI TECNOST PORTUGAL, S.A.<br>(sale of office equipment and accessories)  | LISBON<br>(PORTUGAL)        | EUR      | 275,000       | 99.9927                                    |                    | OLIVETTI INTERNATIONAL B.V.  |
| TIEMME SISTEMI S.r.l.<br>(electric, electromechanical, electronic equipment and related systems)   | CARSOLI<br>(L AQUILA ITALY) | EUR      | 1,040,000     | 100.0000                                   |                    | OLIVETTI S.p.A.  |
| TIESSE S.c.p.A.<br>(installation and assistance for electromechanical, electronic, computer, telematic and telecommunications equipment) | ROME<br>(ITALY)             | EUR      | 103,292       | 42.0000<br>19.0000                         |                    | OLIVETTI S.p.A.<br>TIEMME SISTEMI S.r.l.                                     |
| TOP SERVICE S.p.A.<br>(electronic diagnostics and repairs of computer products)  | MODUGNO<br>(BARI ITALY)     | EUR      | 564,650       | 91.2100                                    |                    | OLIVETTI S.p.A.  |
| WIRELAB S.p.A.<br>(repairs, management and assistance of fixed telecommunications and other equipment)                                   | SCARMAGNO<br>(TURIN ITALY)  | EUR      | 300,000       | 70.0000                                    |                    | OLIVETTI S.p.A.  |
| <b>OTHER ACTIVITIES</b>  |                             |          |               |  |                    |  |
| ASCAI SERVIZI S.r.l.<br>(insurance mediation)  | ROME<br>(ITALY)             | EUR      | 73,337        | 64.9599                                    |                    | SAIAT SOCIETA<br><br>ATTIVITA INTERMEDIE AUSILIARIE<br>TLC P.A.              |
| CONS. FORM. PROF.MEZZOGIORNO<br>D ITALIA E PAESI AREA<br>MEDITERRANEA-NAUTILUS<br>(professional training)                                | ROME<br>(ITALY)             | EUR      | 30,000        | 31.0000<br><br>20.0000                     |                    | TELECOM ITALIA LEARNING<br>SERVICES S.p.A.<br><br>MEDITERRANEAN NAUTILUS Ltd |
| CONSORZIO ENERGIA GRUPPO<br>TELECOM ITALIA<br>(coordination of power for fixed and mobile networks of consortia)                         | ROME<br>(ITALY)             | EUR      | 10,000        | 50.0000<br>50.0000                         |                    | TELECOM ITALIA S.p.A.<br><br>TIM ITALIA S.p.A.                               |
| DATACOM S.A.   | LA PAZ<br>(BOLIVIA)         | BOB      | 66,938,200    | 100.0000                                   |                    | ENTEL S.A. EMPRESA NACIONAL DE<br>TELECOMUNICACIONES                         |



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(data transmission services)

|   |                            |     |               |          |   |
|---|----------------------------|-----|---------------|----------|---|
| DOMUS ACADEMY S.p.A.<br>(specialized design courses)  | MILAN<br>(ITALY)           | EUR | 140,000       | 67.3336  | TELECOM ITALIA S.p.A.                           |
| EDOTEL S.p.A.<br>(holding company)  | TURIN<br>(ITALY)           | EUR | 4,847,193     | 100.0000 | TELECOM ITALIA FINANCE S.A.                     |
| EMSA Servizi S.p.A.<br>(real estate services management)  | ROME<br>(ITALY)            | EUR | 5,000,000     | 100.0000 | TELECOM ITALIA S.p.A.                           |
| ENTEL S.A.-EMPRESA NACIONAL DE<br>TELECOMUNICACIONES S.A. ENTEL<br>BOLIVIA  | LA PAZ<br><br>(BOLIVIA)    | BOB | 1,280,898,800 | 50.0000  | ETI EURO<br><br>TELECOM INTERNATIONAL N.V.      |
| (telecommunications services)   |                            |     |               |          |   |
| ETI EURO TELECOM INTERNATIONAL<br>N.V.<br><br>(holding company)   | AMSTERDAM<br><br>(HOLLAND) | EUR | 50,050        | 100.0000 | ICH INTERNATIONAL<br>COMMUNICATION HOLDING N.V. |
| EUSTEMA S.p.A.<br>(design, research, development and<br>marketing of software, information and<br>online systems) | ROME<br>(ITALY)            | EUR | 312,000       | 67.3333  | TELECOM ITALIA S.p.A.                           |
| I.T. TELECOM S.r.l.<br>(other software development and<br>software consulting)                                    | MILAN<br>(ITALY)           | EUR | 7,000,000     | 100.0000 | TELECOM ITALIA S.p.A.                           |

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| Name  | Head Office             | Currency | Share Capital | Notes To Consolidated Financial Statements |                                   |
|---|-------------------------|----------|---------------|--|-----------------------------------|
|   |                         |          |               | % ownership                                | % of voting rights                |
|   |                         |          |               |  | Held by                           |
| ICH INTERNATIONAL COMMUNICATION HOLDING N.V.<br>(holding company)                   | AMSTERDAM<br>(HOLLAND)  | EUR      | 50,000        | 100.0000                                   | TELECOM ITALIA INTERNATIONAL N.V. |
| IRIDIUM ITALIA S.p.A. (in liquidation)<br>(satellite telecommunications services)   | ROME<br>(ITALY)         | EUR      | 2,575,000     | 65.0000                                    | TELECOM ITALIA S.p.A.             |
| NETESI S.p.A. (in liquidation)<br>(telecommunications and multimedia services)      | MILAN<br>(ITALY)        | EUR      | 434,715       | 100.0000                                   | TELECOM ITALIA S.p.A.             |
| O&B COSTRUZIONI GENERALI S.r.l.<br>(real estate purchases, exchanges and sales)     | IVREA<br>(TURIN ITALY)  | EUR      | 100,000       | 50.1000                                    | OLIVETTI MULTISERVICES S.p.A.     |
| OFI CONSULTING S.r.l.<br>(administrative consulting)                                | IVREA<br>(TURIN ITALY)  | EUR      | 95,000        | 100.0000                                   | TELECOM ITALIA S.p.A.             |
| OLIVETTI GESTIONI IVREA S.p.A.<br>(real estate services)                            | IVREA<br>(TURIN ITALY)  | EUR      | 1,300,000     | 100.0000                                   | TELECOM ITALIA S.p.A.             |
| OLIVETTI HOLDING B.V.<br>(holding company)  | AMSTERDAM<br>(HOLLAND)  | EUR      | 15,882,770    | 100.0000                                   | TELECOM ITALIA FINANCE S.A.       |
| OLIVETTI INTERNATIONAL (SERVICE) S.A. (in liquidation)<br>(administrative services) | LUGANO<br>(SWITZERLAND) | CHF      | 50,000        | 100.0000                                   | TELECOM ITALIA FINANCE S.A.       |
| OLIVETTI MULTISERVICES S.p.A.<br>(real estate management)                           | MILAN<br>(ITALY)        | EUR      | 20.337.161    | 100.0000                                   | TELECOM ITALIA S.p.A.             |
| OLIVETTI SYSTEMS TECHNOLOGY CORPORATION<br>(real estate management)                 | YOKOHAMA<br>(JAPAN)     | JPY      | 100,000,000   | 100.0000                                   | TELECOM ITALIA FINANCE S.A.       |
| OMS HOLDING B.V.<br>(financing)   | AMSTERDAM<br>(HOLLAND)  | EUR      | 20,000        | 100.0000                                   | OLIVETTI MULTISERVICES S.p.A.     |

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|   |                                 |     |            |                    |  |
|---|---------------------------------|-----|------------|--------------------|--|
| PROGETTO ITALIA S.p.A.<br>(development and improvement of<br>the Telecom Italia brand)            | MILAN<br>(ITALY)                | EUR | 1,000,000  | 100.0000           | TELECOM ITALIA S.p.A.                                |
| RUF GESTION S.A.S.<br>(real estate services)  | PUTEAUX<br>(FRANCE)             | EUR | 266,300    | 100.0000           | OMS HOLDING B.V.                                     |
| SAIAT SOCIETA' ATTIVITA<br>INTERMEDIE AUSILIARIE TLC P.A.<br><br>(financing)                      | TURIN<br><br>(ITALY)            | EUR | 35,745,120 | 100.0000           | TELECOM ITALIA S.p.A.                                |
| SATURN VENTURE PARTNERS<br>LLC<br><br>(financing)   | DELAWARE<br><br>(USA)           | USD | 27,166,100 | 56.9626<br>17.8476 | TELECOM ITALIA LAB SA<br><br>TELECOM ITALIA S.p.A.   |
| TECNOSERVIZI MOBILI S.r.l.<br>(management of movable assets)                                      | ROME<br>(ITALY)                 | EUR | 26,000     | 51.0000            | TELECOM ITALIA S.p.A.                                |
| TECO SOFT ARGENTINA S.A. (in<br>liquidation)<br><br>(design, development and sale of<br>software) | BUENOS AIRES<br><br>(ARGENTINA) | ARS | 12,000     | 99.9917            | TELECOM ITALIA S.p.A.                                |
| TELECOM ITALIA AMERICA<br>LATINA S.A.<br><br>(telecommunications and<br>promotional services)     | SAO PAULO<br><br>(BRAZIL)       | BRL | 43,614,072 | 99.9996            | TELECOM ITALIA S.p.A.                                |
| TELECOM ITALIA AUDIT SCARL<br>(internal auditing for the Telecom<br>Italia Group)                 | MILAN<br>(ITALY)                | EUR | 2,750,000  | 81.8182<br>18.1818 | TELECOM ITALIA S.p.A.<br>TELECOM ITALIA MEDIA S.p.A. |
| TELECOM ITALIA CAPITAL S.A.<br>(financing)  | LUXEMBOURG                      | EUR | 2,336,000  | 99.9990<br>0.0010  | TELECOM ITALIA S.p.A.<br>TELECOM ITALIA FINANCE S.A. |

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| Financial Statements   |                        |          |               | Notes To Consolidated Financial Statements |                    |  |
|--|------------------------|----------|---------------|--|--------------------|--|
| Name   | Head Office            | Currency | Share Capital | % ownership                                | % of voting rights | Held by  |
| TELECOM ITALIA FINANCE S.A.<br>(financing)   | LUXEMBOURG             | EUR      | 542,090,241   | 100.0000                                   |                    | TELECOM ITALIA S.p.A.                                |
| TELECOM ITALIA INTERNATIONAL N.V.<br>(holding company)   | AMSTERDAM<br>(HOLLAND) | EUR      | 2,399,483,000 | 100.0000                                   |                    | TELECOM ITALIA S.p.A.                                |
| TELECOM ITALIA LAB S.A.<br>(holding company)   | LUXEMBOURG             | USD      | 163,870       | 99.9939<br>0.0061                          |                    | TELECOM ITALIA S.p.A.<br>TELECOM ITALIA FINANCE S.A. |
| TELECOM ITALIA LEARNING SERVICES<br>DO BRASIL LIMITADA<br>(information consulting and services)                            | SAO PAULO<br>(BRAZIL)  | BRL      | 174,040       | 99.9989                                    |                    | TELECOM ITALIA LEARNING<br>SERVICES S.p.A.           |
| TELECOM ITALIA LEARNING SERVICES<br>S.p.A.<br>(professional training)  | MILAN<br>(ITALY)       | EUR      | 1,560,000     | 100.0000                                   |                    | TELECOM ITALIA S.p.A.                                |
| TELENERGIA S.r.l.<br>(import, export, purchase, sale and<br>exchange of electrical energy)                                 | ROME<br>(ITALY)        | EUR      | 50,000        | 80.0000<br>20.0000                         |                    | TELECOM ITALIA S.p.A.<br>TIM ITALIA S.p.A.           |
| TELSI Unlimited<br>(financing company)   | LONDON<br>(UK)         | GBP      | 496,661,807   | 100.0000                                   |                    | TELECOM ITALIA FINANCE S.A.                          |
| TELSY ELETTRONICA E<br>TELECOMUNICAZIONI S.p.A.<br>(manufacturing and sale of systems for<br>encrypted telecommunications) | TURIN<br>(ITALY)       | EUR      | 390,000       | 100.0000                                   |                    | TELECOM ITALIA S.p.A.                                |
| TIAUDIT LATAM S.A.<br>(internal auditing)  | SAO PAULO<br>(BRAZIL)  | BRL      | 1,500,000     | 99.9995                                    |                    | TELECOM ITALIA AUDIT SCARL                           |
| TRAINET S.p.A. (in liquidation)<br>(development, operation and sales of<br>teleteaching systems)                           | ROME<br>(ITALY)        | EUR      | 674,446       | 100.0000                                   |                    | TELECOM ITALIA S.p.A.                                |

**Telecom Italia Group****List of consolidated companies held for sale**

| <b>Name</b>   | <b>Head Office</b>     | <b>Currency</b> | <b>Share Capital</b> | <b>% ownership</b> | <b>% of voting rights</b> | <b>Held by</b>              |
|---|------------------------|-----------------|----------------------|--------------------|---------------------------|-----------------------------|
| CORPORACION DIGITEL C.A.<br>(telecommunications services)   | CARACAS<br>(VENEZUELA) | VEB             | 41,214,946,687       | 100.0000           |                           | TIM INTERNATIONAL N.V.      |
| GRUPPO BUFFETTI S.p.A.<br>(manufacture of products regarding<br>the paper industry, printing and<br>publishing) | ROME<br>(ITALY)        | EUR             | 11,817,000           | 100.0000           |                           | TELECOM ITALIA MEDIA S.p.A. |
| OFFICE AUTOMATION PRODUCTS<br>S.r.l. (in liquidation)<br><br>(wholesale of magnetic supports)                   | ROME<br>(ITALY)        | EUR             | 90,000               | 100.0000           |                           | GRUPPO BUFFETTI S.p.A.      |
| SK DIRECT S.r.l.<br>(graphic arts)  | ROME<br>(ITALY)        | EUR             | 1,570,507            | 100.0000           |                           | GRUPPO BUFFETTI S.p.A.      |

### **Telecom Italia Group**

#### **List of associated and jointly controlled companies accounted for by the equity method**

| <b>Name</b>                                  | <b>Head Office</b> | <b>Currency</b> | <b>Share Capital</b> | <b>% ownership</b> | <b>% of voting rights</b> | <b>Held by</b>                                       |
|--|--------------------|-----------------|----------------------|--------------------|---------------------------|--|
| ARCHEO S.p.A. (in liquidation)<br>(services) | BARI<br>(ITALY)    | EUR             | 464,400              | 25.0000            |                           | OFI CONSULTING S.r.l.                                |
| AREE URBANE S.r.l.<br>(real estate)          | MILAN<br>(ITALY)   | EUR             | 307,717              | 31.6499<br>0.9700  |                           | TELECOM ITALIA S.p.A.<br>TELECOM ITALIA MEDIA S.p.A. |

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| Name   | Financial Statements           |          |                       | Notes To Consolidated Financial Statements |                    |  |
|--|--------------------------------|----------|-----------------------|--|--------------------|--|
|  | Head Office                    | Currency | Share Capital         | % ownership                                | % of voting rights | Held by                                    |
| ASSCOM INSURANCE<br>BROKERS S.r.l.<br><br>(insurance mediation)  | MILAN<br><br>(ITALY)           | EUR      | 100,000               | 20.0000                                    |                    | TELECOM ITALIA S.p.A.                      |
| AVEA ILETISIM HIZMETLERI<br>A.S.<br><br>(mobile telephony operator)  | ISTANBUL<br><br>(TURKEY)       | TRY      | 7,024,867,230,970,000 | 40.5647                                    |                    | TIM INTERNATIONAL N.V.                     |
| BALTEA S.r.l.<br>(manufacture and sale of office<br>equipment and computer and<br>telecommunications services)                   | IVREA<br>(TURIN)<br><br>ITALY) | EUR      | 2,220,000             | 49.0000                                    |                    | OLIVETTI S.p.A.                            |
| BROAD BAND SERVICE S.A.<br><br>(production and sales of<br>multimedia services)  | REPUBLIC OF<br><br>SAN MARINO  | EUR      | 258,000               | 20.0000                                    |                    | TELECOM ITALIA SAN<br>MARINO S.p.A.        |
| CABLE INSIGNIA S.A. (in<br>liquidation)<br><br>(telecommunications services)   | ASUNCIÓN<br><br>(PARAGUAY)     | PYG      | 2,600,000,000         | 75.0000                                    |                    | TELECOM PERSONAL S.A.                      |
| CONSORZIO DREAM FACTORY<br>(in liquidation)<br><br>(promotion of new economy<br>development in the weak areas of<br>the country) | ROME<br><br>(ITALY)            | EUR      | 20,000                | 20.0000                                    |                    | TELECOM ITALIA S.p.A.                      |
| CONSORZIO E O (in liquidation)<br><br>(professional training)  | ROME<br><br>(ITALY)            | EUR      | 30,987                | 50.0000                                    |                    | TELECOM ITALIA S.p.A.                      |
| CONSORZIO IRI TELEMATICA<br>CALABRIA TELCAL<br><br>(planning and development of the<br>Piano Telematico Calabria<br>project)     | CATANZARO<br><br>(ITALY)       | EUR      | 877,975               | 24.0000                                    |                    | TELECOM ITALIA S.p.A.                      |
| CONSORZIO REISS FORM<br><br>(training and consulting services<br>for training and management)                                    | ROME<br><br>(ITALY)            | EUR      | 51,646                | 50.0000                                    |                    | TELECOM ITALIA LEARNING<br>SERVICES S.p.A. |
|  | NAPLES                         | EUR      | 25,821                | 30.0000                                    |                    | TELECOM ITALIA S.p.A.                      |

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CONSORZIO S.I.A.R.C. (in liquidation) (ITALY)

(supply of information products and services)

|  |                |     |         |         |                   |
|--|----------------|-----|---------|---------|-------------------|
| CONSORZIO SCUOLA SUPERIORE ALTA FORMAZIONE UNIVERSITARIA FEDERICO II | NAPLES (ITALY) | EUR | 129,114 | 20.0000 | TIM ITALIA S.p.A. |
|--|----------------|-----|---------|---------|-------------------|

(professional training)

|  |              |     |        |         |                       |
|--|--------------|-----|--------|---------|-----------------------|
| CONSORZIO TURISTEL (online tourism services) | ROME (ITALY) | EUR | 77,460 | 33.3333 | TELECOM ITALIA S.p.A. |
|--|--------------|-----|--------|---------|-----------------------|

|  |               |     |               |         |                                   |
|--|---------------|-----|---------------|---------|-----------------------------------|
| Empresa de Telecomunicaciones de Cuba S.A. ETEC-SA | HAVANA (CUBA) | USD | 1,749,313,080 | 27.0030 | TELECOM ITALIA INTERNATIONAL N.V. |
|--|---------------|-----|---------------|---------|-----------------------------------|

(telecommunications services)

|  |               |     |         |         |                       |
|--|---------------|-----|---------|---------|-----------------------|
| IM.SER S.p.A. (real estate management) | TURIN (ITALY) | EUR | 889,950 | 40.0000 | TELECOM ITALIA S.p.A. |
|--|---------------|-----|---------|---------|-----------------------|

|                                     |               |     |         |         |                       |
|-------------------------------------|---------------|-----|---------|---------|-----------------------|
| IN.VA. S.p.A. (information systems) | AOSTA (ITALY) | EUR | 520,000 | 40.0000 | TELECOM ITALIA S.p.A. |
|-------------------------------------|---------------|-----|---------|---------|-----------------------|

|  |                 |     |         |         |                |
|--|-----------------|-----|---------|---------|----------------|
| INTERCALL HELLAS (telecommunications services and sale of prepaid telephone cards) | ATHENS (GREECE) | EUR | 496,696 | 29.4100 | INTERCALL S.A. |
|--|-----------------|-----|---------|---------|----------------|

|  |            |     |           |         |                             |
|--|------------|-----|-----------|---------|-----------------------------|
| ISCE Investors in Sapient & Cuneo Europe S.A. (investment company) | LUXEMBOURG | EUR | 4,334,400 | 25.0000 | TELECOM ITALIA MEDIA S.p.A. |
|--|------------|-----|-----------|---------|-----------------------------|

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|--|--------------------------------|----------|---------------|--|--------------------|---|
| Name   | Head Office                    | Currency | Share Capital | % ownership                                | % of voting rights | Held by                                 |
| ITALTEL HOLDING S.p.A.<br>(holding company)  | MILAN<br>(ITALY)               | EUR      | 115,459,344   | 19.3733                                    |                    | TELECOM ITALIA FINANCE S.A.             |
| LI.SIT. LOMBARDIA INTEGRATA<br>SERVIZI INFOTELEMATICI PER IL<br>TERRITORIO S.p.A.<br><br>(information and TLC services and<br>products for the local public<br>administration) | MILAN (ITALY)                  | EUR      | 6,500,000     | 24.2000                                    |                    | TELECOM ITALIA S.p.A.                   |
| LUNA ROSSA CHALLENGE 2007<br>S.L.<br><br>(development, organization of<br>sail race, America's Cup included)   | VALENCIA<br>(SPAIN)            | EUR      | 4,000,000     | 49.0000                                    |                    | TELECOM ITALIA S.p.A.                   |
| LUNA ROSSA TRADEMARK s.a.r.l.<br>(acquisition, maintenance,<br>development of intellectual property)   | LUXEMBOURG                     | EUR      | 20,000,000    | 49.0000                                    |                    | TELECOM ITALIA S.p.A.                   |
| MATERIAL CONNEXION MILANO<br>S.r.l.<br><br>(maintenance of software)   | MILAN (ITALY)                  | EUR      | 100,000       | 20.0000                                    |                    | DOMUS ACADEMY S.p.A.                    |
| MIAECONOMIA S.r.l.<br>(publishing in the field of personal<br>finance)   | ROME<br>(ITALY)                | EUR      | 1,000,000     | 30.0000                                    |                    | MATRIX S.p.A.                           |
| MICRO SISTEMAS S.A.<br><br>(telecommunications services)   | BUENOS<br>AIRES<br>(ARGENTINA) | ARS      | 210,000       | 99.9900<br>0.0100                          |                    | TELECOM ARGENTINA S.A.<br>PUBLICOM S.A. |
| MOVENDA S.p.A.<br>(technological platforms for the<br>development of mobile Internet<br>services)  | ROME<br>(ITALY)                | EUR      | 133,333       | 24.9998                                    |                    | TELECOM ITALIA LAB SA                   |
| NAVIGATE CONSORTIUM<br>(terrestrial and satellite network<br>integration)  | MILAN<br>(ITALY)               | EUR      | 582,716       | 20.0000                                    |                    | TELECOM ITALIA S.p.A.                   |
| NORDCOM S.p.A.<br>(application service provider)   | MILAN<br>(ITALY)               | EUR      | 5,000,000     | 42.0000                                    |                    | TELECOM ITALIA S.p.A.                   |
| NORTEL INVERSORA S.A.<br><br>(holding company)   | BUENOS<br>AIRES<br>(ARGENTINA) | ARS      | 78,633,050    | 51.0400                                    | 67.7883            | SOFORA TELECOMUNICACIONES<br>SA         |



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|  |                                      |     |                 |                             |   |
|--|--------------------------------------|-----|-----------------|-----------------------------|---|
| NUCLEO S.A.<br>(telecommunications services)   | ASUNCIÓN<br>(PARAGUAY)               | PYG | 175,200,000,000 | 67.5000                     | TELECOM PERSONAL S.A.   |
| OCN-TRADING S.r.l. (in liquidation)<br>(trading company)   | IVREA (TURIN<br>ITALY)               | EUR | 40,800          | 40.0000                     | TELECOM ITALIA S.p.A.   |
| OLITECNO S.A. DE C.V. (in<br>liquidation)  | MEXICO D.F.<br>(MEXICO)              | MXN | 1,000,000       | 50.0000                     | OLIVETTI MEXICANA S.A. (in<br>liquidation)                    |
| (manufacture and sale of products for<br>the telecommunications industry)  |                                      |     |                 |                             |   |
| PERSEO S.r.l.<br>(acquisition, sale, change, lease,<br>administration and maintenance of<br>registered real estate for every use<br>and destination) | CASELLE<br>TORINESE<br>(TURIN ITALY) | EUR | 20,000          | 50.0000                     | TELECOM ITALIA S.p.A.   |
| PUBLICOM S.A.<br>(telecommunications services)   | BUENOS<br>AIRES<br>(ARGENTINA)       | ARS | 16,000,000      | 99.9900<br>0.0100           | TELECOM ARGENTINA S.A.<br>NORTEL INVERSORA S.A.               |
| SHARED SERVICE CENTER SCARL<br>(planning, design, installation running<br>of computer services)  | MILAN (ITALY)                        | EUR | 1,756,612       | 40.9090<br>4.5455<br>4.5455 | TELECOM ITALIA S.p.A. OLIVETTI<br>S.p.A.<br>TIM ITALIA S.p.A. |

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| Name  | Head Office              | Currency | Share Capital | Notes To Consolidated Financial Statements |  |
|---|--------------------------|----------|---------------|--|--|
|   |                          |          |               | % ownership                                | % of voting rights   |
|   |                          |          |               |  | Held by  |
| SIEMENS INFORMATICA S.p.A.<br>(supply of innovating solutions in the field of electronic and mobile business)         | MILAN (ITALY)            | EUR      | 6,192,000     | 49.0000                                    | TELECOM ITALIA S.p.A.  |
| SOFORA TELECOMUNICACIONES S.A.<br><br>(holding company)   | BUENOS AIRES (ARGENTINA) | ARS      | 439,702,000   | 32.5000<br>17.5000                         | TELECOM ITALIA S.p.A.<br><br>TELECOM ITALIA INTERNATIONAL N.V. |
| SOLPART PARTICIPACOES S.A.<br><br>(holding company for investment in Brasil Telecom Participações S.A.)               | RIO DE JANEIRO (BRAZIL)  | BRL      | 1,657,200,000 | 38.0000                                    | TELECOM ITALIA INTERNATIONAL N.V.                              |
| TELBIO S.p.A.<br>(technological services supporting the health sector)  | MILAN (ITALY)            | EUR      | 4,083,330     | 31.0345                                    | TELECOM ITALIA S.p.A.  |
| TELECOM ARGENTINA S.A.<br><br>(telecommunications services)   | BUENOS AIRES (ARGENTINA) | ARS      | 984,380,978   | 54.7364                                    | NORTEL INVERSORA S.A.  |
| TELECOM ARGENTINA USA INC.<br>(telecommunications services)   | DELAWARE (USA)           | USD      | 219,973       | 100.0000                                   | TELECOM ARGENTINA S.A.   |
| TELECOM PERSONAL S.A.<br><br>(telecommunications services)  | BUENOS AIRES (ARGENTINA) | ARS      | 310,514,481   | 99.9923<br>0.0077                          | TELECOM ARGENTINA S.A.<br>PUBLICOM S.A.                        |
| TELEGONO S.r.l.<br>(real estate management)   | ROME (ITALY)             | EUR      | 1,000,000     | 40.0000                                    | TELECOM ITALIA S.p.A.  |
| TELELEASING LEASING DI TELECOMUNICAZIONI E GENERALE S.p.A.<br><br>(financial leasing of real estate and other assets) | MILAN (ITALY)            | EUR      | 9,500,000     | 20.0000                                    | SAIAT SOCIETA ATTIVITA INTERMEDIE AUSILIARIE TLC P.A.          |
| TIGLIO I S.r.l.<br>(real estate management)   | MILAN (ITALY)            | EUR      | 5,255,704     | 45.6991<br>2.1027                          | TELECOM ITALIA S.p.A.<br>TELECOM ITALIA MEDIA S.p.A.           |
| TIGLIO II S.r.l.<br>(real estate management)  | MILAN (ITALY)            | EUR      | 14,185,288    | 49.4707                                    | TELECOM ITALIA S.p.A.  |
| UBA- NET S.A. (in liquidation)<br><br>(teleteaching systems)  | BUENOS AIRES (ARGENTINA) | ARS      | 12,000        | 50.0000                                    | TRAINET S.p.A. (in liquidation)                                |

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WEMACOM TELEKOMMUNIKATION GmbH      SCHWERIN (GERMANY)      EUR      60,000      25.0000      HANSENET TELEKOMMUNIKATION GmbH

(telecommunications services)

**Telecom Italia Group**

**Other significant investments in accordance with Consob resolution No. 11971 dated May 14, 1999**

| <b>Name</b>  | <b>Head Office</b>     | <b>Currency</b> | <b>Share Capital</b> | <b>% ownership</b> | <b>% of voting rights</b> | <b>Held by</b>                             |
|--|------------------------|-----------------|----------------------|--------------------|---------------------------|--|
| ATESIA- Telemarketing Comunicazione Telefonica e Ricerche di Mercato S.p.A.<br>(telemarketing) | ROME<br>(ITALY)        | EUR             | 3,150,406            | 19.9000            |                           | TELECOM ITALIA S.p.A.                      |
| CEFRIEL S.r.l.<br>(updating and research in the sector of electronics engineering)             | MILAN<br>(ITALY)       | EUR             | 100,000              | 5.8000<br>5.8000   |                           | TELECOM ITALIA S.p.A.<br>TIM ITALIA S.p.A. |
| CELL-TEL S.p.A.<br>(telecommunications equipment, installations and systems)                   | IVREA<br>(TURIN ITALY) | EUR             | 500,000              | 15.0000            |                           | OLIVETTI S.p.A.                            |

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| Name   | Financial Statements            |          |               | Notes To Consolidated Financial Statements |                    |                             |
|--|---------------------------------|----------|---------------|--|--------------------|-----------------------------|
|  | Head Office                     | Currency | Share Capital | % ownership                                | % of voting rights | Held by                     |
| FIN.PRIV. S.r.l.<br>(financing)  | MILAN<br>(ITALY)                | EUR      | 20,000        | 14.2900                                    |                    | TELECOM ITALIA S.p.A.       |
| IFM INFOMASTER S.p.A.<br>(planning and development of call center solutions)                       | GENOA<br>(ITALY)                | EUR      | 161,765       | 12.0000                                    |                    | TELECOM ITALIA LAB S.A.     |
| INNOVIS S.p.A.<br>(computer, online and telecommunications equipments and services)                | IVREA<br>(TURIN ITALY)          | EUR      | 325,000       | 15.0000                                    |                    | OLIVETTI S.p.A.             |
| INSULA S.p.A.<br>(telecommunications services)   | VENICE-MESTRE<br>(ITALY)        | EUR      | 2,064,000     | 12.0000                                    |                    | TELECOM ITALIA S.p.A.       |
| ITALBIZ.COM Inc.<br><br>(Internet services)  | LOS ANGELES<br>(USA)            | USD      | 4,720         | 19.5000                                    |                    | TELECOM ITALIA MEDIA S.p.A. |
| LEISURE LINK HOLDINGS ltd<br><br>(manufacture of gaming and leisure-time machines)                 | STAFFORDSHIRE<br>(UK)           | GBP      | 7,809,179     | 11.4700                                    |                    | TELECOM ITALIA FINANCE S.A. |
| LOCATIONET SYSTEM Ltd<br>(development of middle-ware platform for the supply of location services) | NETANYA<br>(ISRAEL)             | NIS      | 0             | 12.9700                                    |                    | TELECOM ITALIA LAB S.A.     |
| OGER TELECOM LIMITED<br>(holding company)  | DUBAY<br>(UNITED ARAB EMIRATES) | USD      | 1,500,000,000 | 13.3300                                    |                    | TIM INTERNATIONAL N.V.      |
| PAS GROUP Professional Application Software S.r.l.<br><br>(software production)                    | MILAN<br><br>(ITALY)            | EUR      | 91,800        | 16.6700                                    |                    | EUSTEMA S.p.A.              |
| PIEDMONT INTERNATIONAL S.A.<br><br>(financing)   | LUXEMBOURG                      | USD      | 10,507,500    | 17.1300                                    | 10.3000            | TELECOM ITALIA FINANCE S.A. |
| RETAIL NETWORK SERVICES B.V.<br><br>(holding company)  | AMSTERDAM<br>(HOLLAND)          | EUR      | 15,129,484    | 13.6500                                    |                    | OLIVETTI S.p.A.             |
| TWICE SIM S.p.A.<br><br>(investment services)  | MILAN<br><br>(ITALY)            | EUR      | 8,450,000     | 14.2300                                    |                    | TELECOM ITALIA MEDIA S.p.A. |

|  |                   |     |        |         |                                |
|--|-------------------|-----|--------|---------|--------------------------------|
| USABLENET INC<br>(development of software for the<br>analysis of web site usability) | DELAWARE<br>(USA) | USD | 4      | 18.1081 | TELECOM ITALIA LAB SA          |
| WAVEMARKET INC.<br><br>(holding company)   | DELAWARE<br>(USA) | USD | 25,183 | 11.0100 | SATURN VENTURE<br>PARTNERS LLC |

**NOTE 42 TRANSITION TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRS)**

Until the end of 2004, Telecom Italia prepared its consolidated financial statements and other interim information (including quarterly and six-month data) in accordance with Italian generally accepted accounting principles (Italian GAAP).

Beginning from the year 2005, Telecom Italia prepares its interim consolidated financial statements and annual consolidated financial statements in accordance with IFRS. Beginning from the year 2006, Telecom Italia will also prepare its Italian statutory financial statements in accordance with these same standards.

Given the Recommendations of CESR (Committee of European Securities Regulators) published on December 30, 2003 containing guidelines for companies listed within the EU regarding the transition to IFRS, the information required by IFRS 1 is provided. Such information regards the impact that the conversion to International Financial Reporting Standards (IFRS) has as of and for the year ended December 31, 2004, on the consolidated financial position, the consolidated statements of operations and cash flows presented.

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**Notes To Consolidated Financial Statements**

The footnotes describe the basis of transition for the first-time application of IFRS (IFRS 1) and the other IFRS elected, including the assumptions made by the directors on the IFRS standards and interpretations in force and on the accounting policies adopted for the preparation of the first complete financial statements in accordance with IFRS at December 31, 2005.

As described in greater detail in the following paragraphs, the consolidated balance sheets and the consolidated statements of operations in accordance with IFRS have been derived from the consolidated data, prepared in accordance with the provisions of Italian law, by making the appropriate IFRS adjustments and reclassifications to reflect the changes in the presentation, recognition and valuation required by IFRS.

In particular, adjustments have been made to conform with IFRS in effect as of December 31, 2005 and which have been used for preparation of the opening balance sheet at January 1, 2004 and the consolidated financial statements prepared in accordance with IFRS at December 31, 2004.

The accounting statements and the reconciliations have been prepared solely for purpose of preparing the first complete consolidated financial statements in accordance with IFRS.

For purposes of the presentation of the effects of the transition to IFRS and to satisfy the rules for disclosure indicated in paragraphs 39 a) and b) and 40 of IFRS 1 of the effects of the first-time application of IFRS, the Telecom Italia Group has followed the example contained in paragraph IG 63 of IFRS 1.

The effects of the transition to IFRS are the result of changes in accounting principles and, consequently, as required by IFRS 1 are reflected in the opening shareholders' equity at the date of transition (January 1, 2004). In the transition to IFRS, the estimates previously formulated in accordance with Italian GAAP have been maintained, unless the adoption of IFRS has required the calculation of estimates in accordance with different methods.

**RULES FOR THE FIRST-TIME ADOPTION, ACCOUNTING OPTIONS ELECTED IN THE IFRS FIRST-TIME ADOPTION AND IFRS SELECTED BY THE TELECOM ITALIA GROUP**

The restatement of the opening consolidated balance sheet at January 1, 2004 and of the consolidated financial statements for the year ended December 31, 2004 has also required the Telecom Italia Group to elect the following options among those provided by IFRS:

- **financial statement presentation:** the current/non-current classification has been adopted for the balance sheet, which is generally applied by industrial and commercial enterprises, while the classification of expenses by nature has been elected for the statement of operations. This has required the reclassification of the historical financial statements prepared in accordance with the formats provided by Legislative Decree 127/1991;

- **optional exemptions provided by IFRS 1 upon first-time application of IFRS (January 1, 2004):**

**valuations of property, plant and equipment, investment property and intangible assets at fair value or, alternatively, at revalued cost as the deemed cost:** for certain categories of property, plant and equipment, revalued cost has been adopted instead of cost;

**share-based payments:** the Group has chosen to apply the exemptions allowed in IFRS 1, paragraph 25 B, and has therefore not applied IFRS 2 to stock options plans granted before November 7, 2002, partly in view of the fact that there were no changes in the terms and conditions of those plans;

**business combinations:** for the first-time application of IFRS to any business combination, the purchase method set out in IFRS 3 has been applied prospectively beginning from January 1, 2004. This has led to the cessation of amortization of goodwill and of differences on consolidation recorded at January 1, 2004;

**reserve for net translation differences deriving from the translation of the financial statements of foreign operations:** as allowed by IFRS 1, the cumulative net translation differences deriving from previous translations of the financial statements of foreign operations have not been recognized at the date of transition (January 1, 2004); only those arising subsequent to that date, instead, have been recognized;

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**classification and measurement of financial instruments:** IAS 32 (Financial Instruments: Disclosures and Presentation) and IAS 39 (Financial Instruments: Recognition and Measurement), have been adopted earlier, as allowed, on January 1, 2004 (instead of application starting from the financial statements for the periods beginning on or after January 1, 2005);

**designation date of financial instruments as instruments at fair value through profit or loss or as available for sale:** as allowed by IFRS 1, the designation of financial instruments as a financial asset at fair value through profit or loss or available for sale has been carried out at the transition date (January 1, 2004) instead of at the date of initial recognition provided by IAS 39;

**derecognition of financial assets and liabilities:** in accordance with IFRS 1, if certain non-derivative financial assets and/or liabilities pertaining to transactions that occurred before January 1, 2004 have been derecognized in accordance with previous accounting policies, those assets and/or liabilities do not have to be recognized (and therefore re-recognized in the financial statements) in accordance with IAS 39, except in cases in which the information needed to apply IAS 39 to assets and/or liabilities derecognized as a result of past transactions was available at the time of initially accounting for those transactions. The Telecom Italia Group has taken advantage of such option and has applied the derecognition of non-derivative financial assets/liabilities prospectively from January 1, 2003.

The election of the above options was mainly dictated by the simplicity of their application exception for the Classification and measurement of financial instruments and the Designation date of financial instruments as instruments at fair value through profit or loss or as available for sale for which early adoption at January 1, 2004 was elected (instead of January 1, 2005) to correspond with the transition date to IFRS;

- **accounting treatments selected from the accounting options provided by IFRS:**

**inventories:** in accordance with IAS 2, the cost of inventories should be determined by using the FIFO method or the weighted average cost method. The Telecom Italia Group has elected to use the weighted average cost method for each movement;

**valuation of tangible assets and intangible assets:** subsequent to the initial recording at cost, IAS 16 and IAS 38 provide that these assets may be valued at cost (and depreciated/amortized) or at fair value. The Telecom Italia Group has elected to adopt the cost method;

**valuation of investment property:** in accordance with IAS 40, a property held as an investment property should be initially recorded at cost, including directly chargeable incidental costs. Subsequently, that property may be valued at fair value or at cost. The Telecom Italia Group has elected to adopt the cost method;

**borrowing costs:** for the purposes of recording borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset, IAS 23 provides that an entity may apply the benchmark accounting treatment, which provides for the immediate expensing of borrowing costs, or the allowed alternative accounting treatment, which provides, in the presence of certain conditions, for the capitalization of borrowing costs. The Telecom Italia Group has elected to record borrowing costs in the statement of operations;



**accounting for interests in joint ventures in the consolidated financial statements:** in accordance with IAS 31, interests in joint ventures may be accounted for by using the equity method or, alternatively, using the proportionate consolidation method. The Telecom Italia Group has elected to adopt the equity method.

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**Table of Contents****Financial Statements****Notes To Consolidated Financial Statements****PRINCIPAL IMPACT OF THE APPLICATION OF IFRS ON THE OPENING BALANCE SHEET AS OF JANUARY 1, 2004 AND CONSOLIDATED FINANCIAL STATEMENTS AS OF DECEMBER 31, 2004**

The differences arising from the application of IFRS compared to Italian GAAP as well as Telecom Italia's election of the accounting options provided by IFRS described above, require a restatement of the financial statements prepared in accordance with the previous Italian regulations on financial statements resulting in significant effects, in some cases, on shareholders' equity and net financial debt of the Group, which can be summarized as follows:

**Opening balance sheet as of January 1, 2004:**

|   | <u>Italian GAAP</u> | <u>IFRS<br/>Adjustments</u> | <u>IFRS</u>   |
|---|---------------------|-----------------------------|---------------|
|   | (millions of Euro)  |                             |               |
| <b>Shareholders' equity:</b>                              |                     |                             |               |
| • Shareholders' equity attributable to the Group          | 16,092              | 163                         | 16,255        |
| • Shareholders' equity attributable to Minority interests | 4,497               | 32                          | 4,529         |
| <b>Total</b>  | <b>20,589</b>       | <b>195(*)</b>               | <b>20,784</b> |

(\*) Following the publishing of the Operating guide for the transition to the IFRS international accounting standards by the O.I.C in October 2005, the amounts due from shareholders for subscribed capital unpaid of 4 million at January 1, 2004 were reversed from assets and recorded directly as a deduction of Shareholders' equity attributable to the Group.

**Consolidated financial statements as of December 31, 2004:**

|   | <u>Italian GAAP</u> | <u>IFRS<br/>Adjustments</u> | <u>IFRS</u>   |
|---|---------------------|-----------------------------|---------------|
|   | (millions of Euro)  |                             |               |
| <b>Shareholders' equity:</b>                              |                     |                             |               |
| • Shareholders' equity attributable to the Group          | 15,172              | 1,076                       | 16,248        |
| • Shareholders' equity attributable to Minority interests | 4,689               | (139)                       | 4,550         |
| <b>Total</b>  | <b>19,861</b>       | <b>937(*)</b>               | <b>20,798</b> |
| <b>Net income:</b>  |                     |                             |               |
| • attributable to the Group                               | 781                 | 1,034                       | 1,815         |
| • attributable to Minority interests                      | 1,121               | (102)                       | 1,019         |
| <b>Total</b>  | <b>1,902</b>        | <b>932</b>                  | <b>2,834</b>  |

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(\*) Following the publishing of the Operating guide for the transition to the IFRS international accounting standards by the O.I.C in October 2005, the amounts due from shareholders for subscribed capital unpaid of 45 million at December 31, 2004 were reversed from assets and recorded for 3 million directly as a deduction of Shareholders' equity attributable to the Group and for 42 million directly as a deduction of Shareholders' equity attributable to Minority interests.

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In particular, the principal adjustments can be summarized as follows:

|  | Shareholders<br>equity at<br>January 1,<br>2004 | Shareholders<br>equity at<br>December 31,<br>2004 | Net income<br>for the<br>year 2004 |
|--|---|---|------------------------------------|
|  | (millions of Euro)                              |   |                                    |
| <b>TOTAL AMOUNT (ATTRIBUTABLE TO THE GROUP AND THE<br/>MINORITY INTERESTS) ACCORDING TO ITALIAN GAAP</b> | <b>20,589</b>                                   | <b>19,861</b>                                     | <b>1,902</b>                       |
| <b>less: minority interests</b>  | <b>(4,497)</b>                                  | <b>(4,689)</b>                                    | <b>(1,121)</b>                     |
| <b>ATTRIBUTABLE TO THE GROUP ACCORDING TO ITALIAN GAAP</b>   | <b>16,092</b>                                   | <b>15,172</b>                                     | <b>781</b>                         |
| <b>ADJUSTMENTS TO ITEMS OF THE STATEMENT OF OPERATIONS<br/>ACCORDING TO ITALIAN GAAP:</b>                |   |   |                                    |
| 1) goodwill and differences on consolidation   |   | 1,549   | 1,549                              |
| 2) scope of consolidation  | 141   | 78  | (46)                               |
| 3) factoring transactions  |   |   |                                    |
| 4) sale and lease back of properties   | (199)   | (290)   | (91)                               |
| 5) reserves for risks and future charges   | 340   | (1)   | (318)                              |
| 6) notes and bonds (including convertible and exchangeable notes<br>and bonds)                           | 489   | 406   | (83)                               |
| 7) derivative financial instruments  | (65)  | (283)   | (17)                               |
| 8) treasury stock  | (393)   | (393)   |                                    |
| 9) revenue recognition   | (320)   | (530)   | (210)                              |
| 10) deferred tax assets  | 240   | 190   | (50)                               |
| 11) land   | 86  | 91  | 5                                  |
| 12) employee severance indemnities   | 80  | 70  | (10)                               |
| 13) derecognition of start-up and expansion costs  | (86)  | (61)  | 32                                 |
| 14) value adjustments to tangible and intangible assets produced<br>within the Group                     | (110)   | (83)  | 27                                 |
| 15) restoration costs  | (68)  | (111)   | (43)                               |
| 16) equity investments in listed companies and call options on shares<br>measured at fair value          | 79  | 122   | 2                                  |
| 17) Reversal of amounts due from shareholders for subscribed capital<br>unpaid                           | (4)   | (45)  |                                    |
| Other  | (15)  | (88)  | (57)                               |
| Tax effect on items in reconciliation  |   | 316   | 242                                |
| Items in reconciliation attributable to minority interests   | (32)  | 139   | 102                                |
| <b>AMOUNT ATTRIBUTABLE TO THE GROUP ACCORDING TO IFRS</b>  | <b>16,255</b>                                   | <b>16,248</b>                                     | <b>1,815</b>                       |

The individual adjustments are presented in the table before taxes and minority interests; the tax effects on the reconciliation items and the reconciliation items attributable to minority interests are shown as two separate adjustment items. Moreover, the amounts relating to the effects on assets, liabilities, expenses and revenues presented in the comments on the aforementioned adjustments include the corresponding amounts related to discontinued operations/assets held for sale which, under IFRS 5, in the balance sheets at January 1, 2004 and December 31, 2004, have been classified separately and grouped in the captions *Discontinued operations/assets held for sale* and *Liabilities relating to discontinued operations/assets held for sale* and in the statement of operations in the caption *Net income (loss) from discontinued operations/assets held for sale*.



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|  | As of                                      |                      |
|  | January 1,<br>2004                         | December 31,<br>2004 |
|  | (millions of Euro)                         |                      |
| <b>NET FINANCIAL DEBT ACCORDING TO ITALIAN GAAP</b>  | <b>33,346</b>                              | <b>29,525</b>        |
| Reclassifications: inclusion, in the net financial debt, of non-current receivables from associates and loans to employees and third parties | (204)                                      | (151)                |
| <b>NET FINANCIAL DEBT ACCORDING TO ITALIAN GAAP, AFTER RECLASSIFICATIONS</b>   | <b>33,142</b>                              | <b>29,374</b>        |
| <b>ADJUSTMENTS TO ITEMS OF BALANCE SHEET ACCORDING TO ITALIAN GAAP:</b>  |  |                      |
| 1. goodwill and differences on consolidation   |  |                      |
| 2. scope of consolidation  | 799  | 1,079                |
| 3. factoring transactions  | 351  | 760                  |
| 4. sale and leaseback of properties  | 1,651                                      | 1,603                |
| 5. reserves for risks and future charges   |  |                      |
| 6. notes and bonds (including convertibles and exchangeable notes and bonds)   | (425)                                      | (280)                |
| 7. derivative financial instruments  | 28   | 303                  |
| 8. treasury stock  |  |                      |
| 9. revenue recognition   |  |                      |
| 10. deferred tax assets  |  |                      |
| 11. land   |  |                      |
| 12. employee severance indemnities   |  |                      |
| 13. derecognition of start-up and expansion costs  |  |                      |
| 14. value adjustments to tangible and intangible assets produced within the Group  |  |                      |
| 15. restoration costs  |  |                      |
| 16. equity investments in listed companies and call options on shares measured at fair value   |  |                      |
| 17. reversal of amounts due from shareholders for subscribed capital unpaid  |  |                      |
| Other  | 34   | 23                   |
| <b>NET FINANCIAL DEBT ACCORDING TO IFRS</b>  | <b>35,580</b>                              | <b>32,862</b>        |

Following is a description of the principal IFRS adjustments (described above) made to the Italian GAAP amounts:

- 1) **goodwill and differences on consolidation:** such items are no longer amortized systematically in the statement of operations but are subject to a test, carried out at least annually, to an impairment test. To this end, cash-generating units have been identified to which the relative goodwill has been allocated. Impairment tests were carried out which confirmed the amounts recorded under Italian GAAP.

The impact of the application of IFRS 3 is an increase in total net income for the year 2004 (and therefore total shareholders' equity at December 31, 2004) of 1,549 million (of which 1,525 million attributable to the Group) and is entirely due to the elimination of amortization;

- 2) **scope of consolidation:** the change in the scope of consolidation has led to the inclusion of Special Purpose Entities (SPEs) set up for specific transactions. Furthermore, the line-by-line consolidation of controlling equity investments also determined the elimination of the holdings classified in current assets. Consequently, this principally resulted in: (i) the consolidation at January 1, 2004 of the TIM shares classified in current assets; (ii) the consolidation of the special purpose entity TISV (set up for the securitization transactions) to which receivables are sold and for whose financial needs securities are issued that are subscribed to by third-party investors; and (iii) the consolidation of companies in a wind-up.

Moreover, as part of the corporate integration of Telecom Italia and TIM, on December 21, 2004, Telecom Italia concluded an agreement, called Confirmation of Share Basket Option Transaction for the purchase of call options and the sale of put options, both up to a maximum number of 25 million, each having an underlying basket of shares composed of 2 TIM ordinary shares and 1 TIM savings

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share. The exercise price is equal to 5.57 for each ordinary and savings share. On February 3, 2005, Telecom Italia exercised the call options on 21 million TIM savings shares for a total outlay of 117 million.

On February 8, 2005, the counterparty exercised the put option rights and thus on February 11, 2005, Telecom Italia purchased 42 million TIM ordinary shares for a total outlay of 234 million. The irrevocable commitment which arose at the end of 2004 to purchase the above-mentioned TIM shares in the early months of 2005 determines, for IFRS purposes, the consolidation of a further equity interest in TIM at December 31, 2004 with the consequent recording of a financial liability equal to the total outlay of 351 million and the booking of additional goodwill of 294 million. This accounting treatment thus has the following impact:

- *at January 1, 2004:* an increase in total shareholders' equity of 141 million (of which 178 million is attributable to the Group) owing to the consolidation of TIM shares (and the consequent booking of differences on consolidation in intangible assets) and an increase in net financial debt of 799 million owing to the consolidation of TISV;
- *at December 31, 2004:* an increase in total shareholders' equity of 78 million due mainly to the consolidation of the TIM shares referring to the above put/call options and an increase in the net financial debt of 1,079 million of which 728 million is due to the consolidation of TISV and 351 million relative to the put/call options on TIM shares.

As for securitization transactions and the consequent line-by-line consolidation of the TISV payable, the maximum risk to Telecom Italia was limited solely to the Deferred Purchase Price (DPP) which is equal to about 10% of the receivables sold and which represents the deferred component of the sale price; this risk is therefore considerably lower than the amount of the payable which the application of the accounting policies requires to be consolidated;

- 3) **factoring transactions:** the adoption of IAS 39 and in particular the provisions concerning the derecognition of financial assets (receivables) results in a more restrictive interpretation of the requirements for the recognition of the sale of receivables without recourse (for IFRS purposes, the sale is recognized on condition that all the risks and rewards have substantially been transferred). Accordingly, the receivables sold are added back to the assets and the consideration collected is booked as an advance received.

This treatment has the following impact:

- *at January 1, 2004:* an increase in the net financial debt of 351 million attributable to the recording of a short-term financial payable (advance received) of 351 million, with an increase in trade receivables for the same amount;
  - *at December 31, 2004:* an increase in the net financial position of 760 million attributable to a short-term financial payable (advance received) of 760 million, with an increase in trade receivables for the same amount;
- 4) **sale and leaseback of properties:** some transactions for the sale of properties carried out by the Telecom Italia Group in prior years have been recorded in accordance with the finance method provided by IAS 17 in that the present value of the contractually provided payments approximates the fair value of the properties under lease. Accordingly, in



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the balance sheet, entries are made in the assets for the assets sold and leased back and, in the liabilities, for the residual payable. In the statement of operations, entries are made for the depreciation charge and interest expense instead of the lease payments whereas the gain realized at the time of sale is deferred over the period of the contract. The application of this method has the following impact for the Telecom Italia Group:

- *at January 1, 2004:* a decrease in total shareholders' equity of 199 million (entirely attributable to the Group), before a positive tax effect of 39 million. Such effects have come from an increase in tangible assets (buildings) of 1,363 million, an increase in financial payables of 1,651 million (including deferred gains), an increase in deferred tax assets (net of the reserve for deferred taxes) of 39 million and a decrease of 89 million in the deferred income recorded under Italian GAAP for the deferral of the gains not yet realized with third parties;

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- *at December 31, 2004:* a decrease in total shareholders' equity, entirely attributable to the Group, of 290 million (before a positive tax effect of 70 million), of which 91 million is attributable to a reduction in the net income for the year before tax. Such effects came from an increase in tangible assets (buildings) of 1,282 million, an increase in financial payables of 1,603 million (with a consequent increase in the net financial debt by the same amount), an increase in deferred tax assets (net of the reserve for deferred taxes) of 70 million, and a decrease of 31 million in the deferred income recorded under Italian GAAP for the deferral of the gains not yet realized with third parties. The negative effect on 2004 net income of 91 million, before a tax effect of 31 million, came from a decrease in operating expenses of 106 million (including 187 million for the reversal of the lease payments that were partly compensated by an increase of 81 million for higher depreciation of the assets leased), an increase in net financial expenses of 139 million and the reversal of the gains previously deferred and credited to the statement of operations in 2004 for 58 million;

- 5) **reserves for risks and future charges:** the recognition of these liabilities, in accordance with IFRS, is subject to the existence of specific objective conditions and the discounting of the amounts that are expected to be paid beyond 12 months. In particular, the IFRS opening balance sheet of the Telecom Italia Group at January 1, 2004 benefits from a positive adjustment to opening shareholders' equity for the derecognition of certain reserves for risks and charges recorded in the financial statements in accordance with Italian GAAP. This different accounting treatment, in the IFRS financial statements at December 31, 2004, causes a reduction of net income as a consequence of the reversal of the releases to the statement of operations of the reserves for risks and charges recorded in 2004 under Italian GAAP.

Such impact can be summarized as follows:

- *at January 1, 2004:* an increase in total shareholders' equity of 340 million (of which 225 million attributable to the Group), before a negative tax effect of 101 million (60 million attributable to the Group), to derecognize certain reserves for risks and charges not recognized under IFRS and for the discounting of the other reserves with maturities due beyond 12 months;
- *at December 31, 2004:* a decrease in total shareholders' equity of 1 million, including a decrease in total net income of 318 million (of which 200 million attributable to the Group) before a positive tax effect of 102 million, caused by an increase in operating expenses of 318 million (mainly for the reversal of the releases of the reserves recorded during the year) and a reduction in income taxes of 102 million;

- 6) **notes and bonds (including convertible and exchangeable notes and bonds):** in accordance with Italian GAAP, bonds (including convertible or exchangeable bonds) are recorded at the residual nominal amount (principal); any issue premiums or discounts, as well as issue expenses, are deferred and amortized over the note/bond period.

Under IFRS, notes and bonds (without implicit derivatives) are stated in accordance with the amortized cost method, that is, at the initial amount (fair value) net of repayments of principal already made, adjusted by the amortization (at the effective interest rate) of any differences (such as premiums/discounts, issue expenses and repayment premiums) between the initial amount and the amount repayable at maturity. The amount of compound financial instruments (convertible or exchangeable notes/bonds), under IFRS, should be allocated between the liability component and the implicit derivative financial instrument component. In particular:

- for *notes and bonds convertible into own shares*, the amount of the liability component is the present value of future cash flows based on the market interest rate at the time of issue in reference to instruments having the same characteristics but without the option, whereas the amount of the option is determined as the difference between the net amount received and the amount of the liability component and is recorded as a specific component of shareholders' equity;

- for *notes and bonds exchangeable with other financial instruments issued by companies of the Group and/or third parties*, the amount of the component relative to the derivative financial instrument is extracted and recorded, like sold options, in financial liabilities and valued at fair value (with a contra-entry to the statement of operations) at the end of each period.

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These recording methods have the following impact:

- *at January 1, 2004:* a decrease in the net financial debt of 425 million and an increase in total shareholders equity of 489 million (of which 488 million attributable to the Group), before a negative tax effect of 157 million, including 175 million of deferred taxes on the equity component relative to Telecom Italia 2001-2010 convertible notes. The decrease in debt is principally due to the reclassification of the part of the liability related to convertible notes to shareholders equity, which is partly compensated by the reclassification of the portion of the repayment premium already accrued on the exchangeable Telecom Italia Finance 2001-2006 notes from the reserves for risks and future charges to financial liabilities;
- *at December 31, 2004:* a decrease in the net financial debt of 280 million and an increase in total shareholders equity of 406 million (405 million attributable to the Group), before a negative tax effect of 133 million, including 175 million of deferred taxes on the equity component relative to the Telecom Italia 2001-2010 convertible notes. The decrease in shareholders equity is due to a reduction in pre-tax income of 83 million (entirely attributable to the Group) mainly as a result of the application of the amortized cost method. The decrease in the net financial position is principally due to the reclassification of the part of the liability related to convertible notes/bonds to shareholders equity, which is partly compensated by the reclassification of the portion of the repayment premium already accrued on the exchangeable Telecom Italia Finance 2001-2006 notes from the reserves for risks and future charges to financial liabilities;

7) **derivative financial instruments:** under Italian GAAP, derivative financial instruments are normally presented as off-balance sheet items, whereas under IAS 39, it is mandatory to record derivative financial instruments in the financial statements at fair value. The manner of representing the accounting impact changes according to the purpose the derivative financial instrument is used for:

- hedging instruments designated as fair value hedges must be recorded in assets (liabilities); the derivative financial instrument and the relative hedged item are stated at fair value and the respective changes in value (which generally tend to offset one another) are recognized in the statement of operations;
- hedging instruments designated as cash flow hedges must be recorded in assets (liabilities); the derivative is stated at fair value and the changes in value are recognized, for the effective hedging component, directly in a reserve in equity which is released to the statement of operations in the years in which the cash flows of hedged items will affect the statement of operations;
- derivative financial instruments for managing interest rate and foreign exchange risks, which do not meet the formal conditions for hedge accounting according to IFRS, are recorded in the balance sheet in financial assets/financial liabilities and the changes in value are recognized in the statements of operations.

The recognition in the financial statement of derivative financial instruments at fair value has the following impact:

- *at January 1, 2004:* an increase in the net financial debt of 28 million (substantially attributable to cash flow hedges) and a reduction in total shareholders equity of 65 million, before a positive tax effect of 20 million (64 million attributable to the Group before a positive tax effect of 20 million);
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*at December 31, 2004:* an increase in the net financial debt of 303 million (substantially attributable to cash flow hedges) and a decrease in total shareholders' equity of 283 million (attributable to the Group), before a positive tax effect of 106 million, and with a negative impact of 17 million on the pre-tax income (before a positive tax effect of 7 million);

- 8) **treasury stock:** in accordance with Italian GAAP, treasury stock is recorded in assets and a specific restricted reserve is set up in shareholders' equity. In accordance with IFRS, such stock, instead, is recognized as a reduction of shareholders' equity. The impact of this different accounting treatment is a reduction in total shareholders' equity at January 1, 2004 and at December 31, 2004 of 393 million (entirely attributable to the Group) and a reversal of treasury stock in assets for the same amount;

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- 9) **revenue recognition:** 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 adoption of this method has the following impact, for IFRS purposes:
- *at January 1, 2004:* a decrease in total shareholders equity of 320 million (of which 292 million attributable to the Group), before a positive tax effect of 108 million (of which 103 million attributable to the Group);
  - *at December 31, 2004:* a decrease in total shareholders equity of 530 million (of which 486 million attributable to the Group), before a positive tax effect of 180 million (of which 172 million is relative to the Group); pre-tax income decrease of 210 million (of which 194 million attributable to the Group) before a positive tax effect of 71 million (of which 69 million attributable to the Group);
- 10) **deferred tax assets:** the recognition of deferred tax assets in accordance with IFRS, which were not recorded under Italian GAAP because the conditions of reasonable certainty were not met, has the following impact, under IFRS:
- *at January 1, 2004:* an increase in total shareholders equity of 240 million (entirely attributable to the Group) with the recognition of an asset for deferred taxes on the same amount;
  - *at December 31, 2004:* an increase in total shareholders equity of 190 million ( 196 million attributable to the Group) with the recognition of an asset for deferred taxes of 205 million and also a negative impact of 50 million on total net income (of which 44 million attributable to the Group);
- 11) **land:** in accordance with Italian GAAP, land pertaining to buildings is depreciated together with the same buildings, while in accordance with IFRS it must be classified separately and no longer depreciated. This impact of this different accounting is as follows:
- *at January 1, 2004:* an increase in total shareholders equity of 86 million ( 85 million attributable to the Group), before a negative tax effect of 32 million (for the provision to the reserve for deferred taxes of the same amount), due to the increase of non-current tangible assets of 86 million for the reversal of the accumulated depreciation;
  - *at December 31, 2004:* an increase in total shareholders equity of 91 million (entirely attributable to the Group) of which 6 million is relative to pre-tax income (entirely attributable to the Group) due to lower depreciation (before a negative tax effect of 1 million). In the balance sheet, non-current tangible assets increase by 91 million and a liability for deferred taxes is recognized for 34 million;
- 12) **employee severance indemnities:** Italian GAAP require recognition of the liability for employee severance indemnities (TFR) based on the nominal liability matured to the end of the reporting period, in accordance with statutory regulations. Under IFRS, TFR falls under the category of defined benefit plans subject to actuarial valuation (taking into account mortality, foreseeable changes in salaries/wages, etc.) to express the present value of the benefit, payable upon termination of employment, that employees have matured up to the balance sheet date. Under IFRS, all actuarial gains and losses have been recognized at the date of transition to IFRS. The impact of this different accounting is as follows:

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- *at January 1, 2004:* an increase in total shareholders' equity of 80 million (of which 78 million attributable to the Group), before a negative tax effect of 25 million (for the provision to the reserve for deferred taxes of the same amount), due to a decrease in the reserve for employee severance indemnities of 80 million;
- *at December 31, 2004:* an increase in total shareholders' equity of 70 million (67 million attributable to the Group) before a negative tax effect of 24 million (for the provision to the reserve for deferred taxes of the same amount), due to a decrease in the reserve for employee severance indemnities of 70 million. The total pre-tax income decreases by 10 million (entirely attributable to the Group) as a result of higher charges to the reserve for employee severance indemnities (before a positive tax effect of 3 million);

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- 13) **derecognition of start-up and expansion costs:** in accordance with IFRS, start-up and expansion costs incurred in relation to transactions regarding share capital are directly deducted from the reserves in shareholders' equity at the date of the transaction; and other start-up and expansion costs are charged to the statement of operations, since the requirements to recognize an intangible asset have not been met. This impact of the different accounting treatment is the following:
- *at January 1, 2004:* a decrease in total shareholders' equity of 86 million (79 million attributable to the Group), before a positive tax effect of 13 million (for the recognition of deferred tax assets), due to a decrease in assets no longer capitalizable of 86 million;
  - *at December 31, 2004:* a decrease in total shareholders' equity of 61 million (55 million attributable to the Group) before a positive tax effect of 8 million (for the recognition of deferred tax assets), due to a decrease in assets no longer capitalizable of 61 million. The total pre-tax income increases by 32 million (29 million attributable to the Group) due to lower amortization, before a relative negative tax effect of 11 million;
- 14) **value adjustments to tangible and intangible assets produced within the Group:** the adjustment regards the elimination of intragroup gains on the disposal of tangible and intangible assets produced within the Group prior to 1994. The impact of these adjustments is the following:
- *at January 1, 2004:* a decrease in total shareholders' equity of 110 million (attributable to the Group), before a positive tax effect of 41 million (for the recognition of an asset for deferred taxes) due to the reduction in assets of 110 million;
  - *at December 31, 2004:* a decrease in total shareholders' equity of 83 million (attributable to the Group), before a positive tax effect of 31 million (for the recognition of an asset for deferred taxes), due to the reduction in assets of 83 million. The pre-tax income increases by 27 million (attributable to the Group) due to lower depreciation and amortization, before a relative negative tax effect of 10 million;
- 15) **restoration costs:** under IFRS, the initial cost of tangible assets also includes the expected costs for decommissioning the fixed asset and restoring the site. The corresponding liability is recognized at fair value in the period in which it arises in a balance sheet reserve under reserves for risks and future charges, with a contra-entry to the tangible assets with which it is associated; and the capitalized cost is recognized as an expense in the statement of operations by depreciation of the related tangible assets over their useful lives. The impact of the application of this accounting treatment is the following:
- *at January 1, 2004:* a decrease in total shareholders' equity of 68 million (of which 51 million attributable to the Group), before a positive tax effect of 23 million;
  - *at December 31, 2004:* a decrease in total shareholders' equity of 111 million (of which 78 million attributable to the Group) before a positive tax effect of 35 million; the pre-tax income decreases by 43 million (of which 24 million attributable to the Group) due to higher depreciation, before a positive relative tax effect of 13 million (of which 8 million attributable to the Group);
- 16) **equity investments in listed companies and call options on shares measured at fair value:** in accordance with IFRS, investments in listed companies other than subsidiaries and associates are classified in available-for-sale assets



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or in held for trading assets and recognized at fair value in the financial statements, with the relative value adjustments recorded, respectively, in a specific equity reserve, except for impairment effects, or through profit or loss; and, optional derivatives have been classified as assets held for trading and recognized at fair value in the financial statements, with the relative value adjustments, through profit or loss. The impact of application of this method is the following:

- *at January 1, 2004:* an increase in total shareholders equity of 79 million ( 80 million attributable to the Group), before a positive tax effect of 1 million ( 2 million attributable to the Group);
- *at December 31, 2004:* an increase in total shareholders equity of 122 million (entirely attributable to the Group) which reflects an increase in pre-tax income of 2 million;

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- 17) **derecognition of amounts due from shareholders for subscribed capital unpaid:** amounts due from shareholders for subscribed capital unpaid are derecognized. If related to shareholders of the Group, they are deducted from Shareholders' equity attributable to the Group; and if related to minority shareholders of subsidiaries, they are deducted from minority interests. The application of this method has determined the following impact:
- *at January 1, 2004:* a decrease in the Shareholders' equity attributable to the Group of 4 million;
  - *at December 31, 2004:* a decrease in the Shareholders' equity attributable to the Group of 3 million and shareholders' equity attributable to Minority interests of 42 million.

**Principal changes made to the statement of cash flows**

The statement of cash flows prepared by the Telecom Italia Group up to the financial statements prepared for the year ended December 31, 2004 had the purpose of identifying the net financial requirements or surplus of the Group arising from the change in the net financial debt during the year, whereas the statement of cash flows as defined under IAS 7 tends to reflect the Telecom Italia Group's ability to generate cash and cash equivalents.

According to such principle, other cash equivalents represent highly-liquid short-term financial investments which can readily be converted into cash and which are subject to an irrelevant risk of a change in their value. Therefore, a financial investment is usually classified as a cash equivalent only when it is short term, that is, three months or less to maturity. Financial investments in shares do not fall in the category of cash equivalents.

Bank borrowings generally fall under financing activities unless they are repayable on demand and form an integral part of the management of cash or cash equivalents of an enterprise, in which case they are classified as a reduction of cash and cash equivalents.

IAS 7 requires the statement of cash flows to separately disclose cash flows attributable to operating, investing and financing activities, as follows:

**cash flows attributable to operating activities:** cash flows attributable to operating activities relate to the Group's main revenue-producing activities and are represented by the Telecom Italia Group using the indirect method. According to this method, the net income for the year is adjusted for the effects of transactions which did not involve disbursements or did not give rise to cash (non-monetary transactions) such as, for example, depreciation and amortization, changes in receivables and payables, etc.;

**cash flows attributable to investing activities:** investing activities are disclosed separately because, among other things, they reflect investments/disinvestments effected for the purpose of obtaining future revenues and cash inflows;

**cash flows attributable to financing activities:** financing activities are flows that affect the amount and composition of shareholders' equity and borrowings obtained.

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Attached is the 2004 statement of cash flows prepared in accordance with IFRS.

|   | <b>Year ended<br/>December 31, 2004</b> |
|---|---|
|   | <b>(millions of Euro)</b>               |
| <b>CASH FLOWS ATTRIBUTABLE TO OPERATING ACTIVITIES:</b>   |   |
| Net income from continuing operations   | 2,876                                   |
| <i>Adjustments to reconcile net income from continuing operations with cash flows generated (used) by operating activities:</i> |   |
| Depreciation and amortization   | 5,134                                   |
| Impairment (reversals)/losses on non-current assets (including equity investments)  | 637                                     |
| Net change in deferred tax assets and liabilities   | 1,143                                   |
| Capital (gains)/losses realized on disposal of non-current assets (including equity investments)                                | (106)                                   |
| Share of earnings of equity investments in associates accounted for using the equity method                                     | 4                                       |
| Change in employee severance indemnities and other employee-related reserves  | (41)                                    |
| Change in other operating assets/liabilities:   |   |
| Change in inventories   | (26)                                    |
| Change in trade receivables   | 109                                     |
| Change in trade payables  | 1,091                                   |
| Net change in miscellaneous receivables/payables and other assets/liabilities   | (103)                                   |
| <b>CASH FLOWS GENERATED BY OPERATING ACTIVITIES (A)</b>   | <b>10,718</b>                           |
| <b>CASH FLOWS ATTRIBUTABLE TO INVESTING ACTIVITIES:</b>   |   |
| Acquisition of intangible assets  | (1,935)                                 |
| Acquisition of tangible assets  | (3,389)                                 |
| Acquisition of equity investments in subsidiaries and businesses, net of cash acquired(I)                                       | (1)                                     |
| Acquisition of other equity investments   | (867)                                   |
| Change in financial receivables and other financial assets  | 480                                     |
| Consideration received on the sale of equity investments in subsidiaries, net of cash disposed of (II)                          | 43                                      |
| Consideration received on the sale of tangible, intangible and other non-current assets and capital reimbursements              | 457                                     |
| <b>CASH FLOWS USED BY INVESTING ACTIVITIES (B)</b>  | <b>(5,212)</b>                          |
| <b>CASH FLOWS ATTRIBUTABLE TO FINANCING ACTIVITIES:</b>   |   |
| Net change in current financial liabilities   | 1,155                                   |
| New non-current financial liabilities (including current portion)   | 7,845                                   |
| Repayment of non-current financial liabilities (including current portion)  | (8,413)                                 |
| Consideration received for equity instruments   | 193                                     |
| Share capital increases/repurchases, net of related costs   | 51                                      |
| Dividends paid to minority shareholders (distribution of reserves included)   | (2,780)                                 |
| <b>CASH FLOWS USED BY FINANCING ACTIVITIES (C)</b>  | <b>(1,949)</b>                          |
| Cash flow used by discontinued operations/assets held for sale (D)  | (65)                                    |
| <b>AGGREGATE CASH FLOWS (E=A+B+C+D)</b>   | <b>3,492</b>                            |

|   |              |
|---|--------------|
| <b>NET CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR (F)</b>                 | <b>5,211</b> |
| <b>Net effect of foreign currency translation on net cash and cash equivalents(G)</b> | <b>(36)</b>  |
| <b>NET CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR (H=E+F+G)</b>                 | <b>8,667</b> |

|   | Year ended<br>December 31, 2004 |
|---|---------------------------------|
|   | (millions of Euro)              |
| <b>ADDITIONAL CASH FLOW INFORMATION</b> |                                 |
| Income taxes paid                       | 1,476                           |
| Interest expense paid                   | 2,779                           |
| Interest income received                | 1,025                           |
| Dividends received                      | 35                              |

(I) Net of the change in payables as a result of the relative acquisitions.

(II) Net of the change in receivables as a result of the relative sales.

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**RECONCILIATION OF TOTAL NET CASH AND CASH EQUIVALENTS:**

|  | Year ended<br>December 31,<br>2004 |
|--|------------------------------------|
|  | (millions of<br>Euro)              |
| <b>NET CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR:</b>   |                                    |
| Cash and cash equivalents from continuing operations   | 5,721                              |
| Adjustments to cash and cash equivalents to take into account discontinued operations/assets held for sale | (142)                              |
|  | <b>5,579</b>                       |
| Cash and cash equivalents included in discontinued operations/assets held for sale                         | 142                                |
|  | <b>(A) 5,721</b>                   |
| Bank borrowings repayable on demand from continuing operations   | (510)                              |
| Bank borrowings repayable on demand included in discontinued operations/assets held for sale               | (510)                              |
|  | <b>(B) (510)</b>                   |
|  | <b>(A+B) 5,211</b>                 |
| <b>NET CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR:</b>   |                                    |
| Cash and cash equivalents from continuing operations   | 8,855                              |
| Cash and cash equivalents included in discontinued operations/assets held for sale                         | 80                                 |
|  | <b>(C) 8,935</b>                   |
| Bank borrowings repayable on demand from continuing operations   | (249)                              |
| Bank borrowings repayable on demand included in discontinued operations/assets held for sale               | (19)                               |
|  | <b>(D) (268)</b>                   |
|  | <b>(C+D) 8,667</b>                 |

**CONSOLIDATED BALANCE SHEETS AS OF JANUARY 1, 2004 AND DECEMBER 31, 2004 ACCORDING TO IFRS CONSOLIDATED STATEMENT OF OPERATIONS FOR THE YEAR ENDED AT DECEMBER 31 2004 ACCORDING TO IFRS**

In addition to the reconciliations of shareholders' equity at January 1, 2004 and December 31, 2004, net income for the year 2004 and net financial debt at January 1, 2004 and December 31, 2004, accompanied by comments on the adjustments made to the balances prepared in accordance with Italian GAAP, the balance sheets at January 1, 2004 and December 31, 2004 and the statement of operations for the year 2004 are attached wherein the following is presented for each item in separate columns:

- amounts according to Italian GAAP reclassified in accordance with IFRS presentation;
- adjustments to conform to IFRS; and
- adjusted amounts according to IFRS.

However, those amounts relative to the balance sheet at December 31, 2004 and the statement of operations for the year 2004 exclude the components relative to discontinued operations/assets held for sale, as set forth by IFRS 5, and the relative effects have been presented in a separate column. As stated earlier, to this end, for the year 2004, discontinued operations/assets held for sale are considered the Finsiel group and Digital Venezuela.

Reclassifications made to show the components making up discontinued operations/assets held for sale (only for the balance sheet at December 31, 2004 and the statement of operations for the year 2004) are shown separately, for the balance sheet components, in an asset caption (discontinued operations/assets held for sale) and in a liability caption (liabilities relating to discontinued operations/assets held for sale) and, for the statement of operations components, in a caption (net of taxes and minority interests) before the net income for the year 2004 (Net income (loss) from discontinued operations/assets held for sale).

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**CONSOLIDATED BALANCE SHEET AS OF JANUARY 1, 2004 (^)**

|  | <u>Italian<br/>GAAP<br/>reclassified</u> |     | <u>IFRS<br/>adjustments</u> | <u>IFRS</u>                 |
|--|--|-----|-----------------------------|-----------------------------|
| (millions of Euro)   |  |     |                             |                             |
| <b>ASSETS</b>  |  |     |                             |                             |
| <b>NON-CURRENT ASSETS</b>                                    |  |     |                             |                             |
| <b>Intangible assets</b>                                     |  |     |                             |                             |
| Goodwill and other intangible assets with an indefinite life | 27,145                                   | a)  | 327                         | 27,472                      |
| Intangible assets with a finite life                         | 6,571                                    | b)  | (86)                        | 6,485                       |
|  | <u>33,716</u>                            |     | <u>241</u>                  | <u>33,957</u>               |
| <b>Tangible assets</b>                                       |  |     |                             |                             |
| Property, plant and equipment owned                          | 18,149                                   | c)  | 253                         | 18,402                      |
| Assets held under finance leases                             | 313                                      | d)  | 1,433                       | 1,746                       |
|  | <u>18,462</u>                            |     | <u>1,686</u>                | <u>20,148</u>               |
| <b>Other non-current assets</b>                              |  |     |                             |                             |
| Equity investments   | 1,863                                    | e)  | (427)                       | 1,436                       |
| Securities and financial receivables                         | 517                                      | (*) | (240)                       | 277                         |
| Miscellaneous receivables and other non-current assets       | 474                                      | f)  | 460                         | 934                         |
|  | <u>2,854</u>                             |     | <u>(207)</u>                | <u>2,647</u>                |
| <b>Deferred tax assets</b>                                   | <u>5,013</u>                             | g)  | <u>243</u>                  | <u>5,256</u>                |
| <b>TOTAL NON-CURRENT ASSETS (A)</b>                          | <u>60,045</u>                            |     | <u>1,963</u>                | <u>62,008</u>               |
| <b>Current Assets:</b>                                       |  |     |                             |                             |
| Inventories  | 321                                      | h)  | 3                           | 324                         |
| Trade and miscellaneous receivables and other current assets | 10,122                                   | i)  | 1,201                       | 11,323                      |
| Equity investments   | 878                                      | l)  | (166)                       | 712                         |
| Securities other than equity investments                     | 1,987                                    | (*) | (1,334)                     | 653                         |
| Financial receivables and other current financial assets     | 1,427                                    | (*) | (291)                       | 1,136                       |
| Cash and cash equivalents                                    | 5,721                                    | (*) |                             | 5,721                       |
| <b>Current Assets sub-total</b>                              | <u>20,456</u>                            |     | <u>(587)</u>                | <u>19,869</u>               |
| <b>Discontinued operations/assets held for sale:</b>         |  |     |                             |                             |
| of a financial nature  |  | (*) |                             |                             |
| of a non-financial nature                                    |  |     |                             |                             |
|  | <u>                    </u>              |     | <u>                    </u> | <u>                    </u> |
| <b>TOTAL CURRENT ASSETS (B)</b>                              | <u>20,456</u>                            |     | <u>(587)</u>                | <u>19,869</u>               |



|  |               |     |              |               |
|--|---------------|-----|--------------|---------------|
| <b>TOTAL ASSETS (A+B)</b>  | <b>80,501</b> |     | <b>1,376</b> | <b>81,877</b> |
| <b>SHAREHOLDERS EQUITY</b>   |               |     |              |               |
| Attributable to the Group  | 16,092        |     | 163          | 16,255        |
| Attributable to Minority interests   | 4,497         |     | 32           | 4,529         |
| <b>TOTAL SHAREHOLDERS EQUITY (C)</b>   | <b>20,589</b> |     | <b>195</b>   | <b>20,784</b> |
| <b>Non-current liabilities:</b>  |               |     |              |               |
| Non-current financial liabilities  | 30,915        | (*) | 825          | 31,740        |
| Employee severance indemnities and other employee-related reserves                 | 1,373         | m)  | (102)        | 1,271         |
| Reserve for deferred taxes   | 252           | n)  | 3            | 255           |
| Reserves for risks and future charges  | 1,197         | o)  | (243)        | 954           |
| Miscellaneous payables and other non-current liabilities                           | 1,780         | p)  | 706          | 2,486         |
| <b>TOTAL NON-CURRENT LIABILITIES (D)</b>   | <b>35,517</b> |     | <b>1,189</b> | <b>36,706</b> |
| <b>Current Liabilities:</b>  |               |     |              |               |
| Current financial liabilities  | 11,879        | (*) | (252)        | 11,627        |
| Trade payables, tax payables, miscellaneous payables and other current liabilities | 12,516        | q)  | 244          | 12,760        |
| <b>Current liabilities sub-total</b>   | <b>24,395</b> |     | <b>(8)</b>   | <b>24,387</b> |
| <b>Liabilities relating to discontinued operations/assets held for sale</b>        |               |     |              |               |
| of a financial nature  |               | (*) |              |               |
| of a non-financial nature  |               |     |              |               |
| <b>TOTAL CURRENT LIABILITIES (E)</b>   | <b>24,395</b> |     | <b>(8)</b>   | <b>24,387</b> |
| <b>TOTAL LIABILITIES (F=D+E)</b>   | <b>59,912</b> |     | <b>1,181</b> | <b>61,093</b> |
| <b>TOTAL SHAREHOLDERS EQUITY AND LIABILITIES (C+F)</b>                             | <b>80,501</b> |     | <b>1,376</b> | <b>81,877</b> |

(^\*) The balance sheet data has been prepared in accordance with IFRS in force at December 31, 2005.

(\*) Item included in net financial debt.

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**CONSOLIDATED BALANCE SHEET AS OF DECEMBER 31, 2004 (^)**

|  | Italian GAAP<br>reclassified |     | IFRS<br>adjustments | IFRS<br>including<br>discontinued<br>operations /<br>assets held<br>for sale | Discontinued<br>operations/<br>assets held<br>for sale<br>Finsiel group -<br>Corporacion<br>Digitel | IFRS          |
|--|------------------------------|-----|---------------------|--|---|---------------|
| (millions of Euro)   |                              |     |                     |  |   |               |
| <b>ASSETS</b>  |                              |     |                     |  |   |               |
| <b>NON-CURRENT ASSETS</b>                                    |                              |     |                     |  |   |               |
| <b>Intangible assets</b>                                     |                              |     |                     |  |   |               |
| Goodwill and other intangible assets with an indefinite life | 25,641                       | a)  | 1,978               | 27,619   | (160)   | 27,459        |
| Intangible assets with a finite life                         | 6,897                        | b)  | (61)                | 6,836  | (62)  | 6,774         |
|  | <b>32,538</b>                |     | <b>1,917</b>        | <b>34,455</b>  | <b>(222)</b>  | <b>34,233</b> |
| <b>Tangible assets</b>                                       |                              |     |                     |  |   |               |
| Property, plant and equipment owned                          | 17,846                       | c)  | 162                 | 18,008   | (155)   | 17,853        |
| Assets held under finance leases                             | 207                          | d)  | 1,446               | 1,653  |   | 1,653         |
|  | <b>18,053</b>                |     | <b>1,608</b>        | <b>19,661</b>  | <b>(155)</b>  | <b>19,506</b> |
| <b>Other non-current assets</b>                              |                              |     |                     |  |   |               |
| Equity investments   | 1,457                        | e)  | (374)               | 1,083  | (19)  | 1,064         |
| Securities and financial receivables                         | 557                          | (*) | (173)               | 384  | 9   | 393           |
| Miscellaneous receivables and other non-current assets       | 329                          | f)  | 568                 | 897  | (16)  | 881           |
|  | <b>2,343</b>                 |     | <b>21</b>           | <b>2,364</b>   | <b>(26)</b>   | <b>2,338</b>  |
| <b>Deferred tax assets</b>                                   | <b>3,706</b>                 | g)  | <b>455</b>          | <b>4,161</b>   | <b>(47)</b>   | <b>4,114</b>  |
| <b>TOTAL NON-CURRENT ASSETS (A)</b>                          | <b>56,640</b>                |     | <b>4,001</b>        | <b>60,641</b>  | <b>(450)</b>  | <b>60,191</b> |
| <b>Current Assets:</b>                                       |                              |     |                     |  |   |               |
| Inventories  | 339                          | h)  | 1                   | 340  | (6)   | 334           |
| Trade and miscellaneous receivables and other current assets | 9,231                        | i)  | 1,412               | 10,643   | (488)   | 10,155        |
| Securities other than equity investments                     | 604                          | (*) | (147)               | 457  |   | 457           |
| Financial receivables and other current financial assets     | 904                          | (*) | (239)               | 665  | (3)   | 662           |
| Cash and cash equivalents                                    | 8,891                        | (*) | 21                  | 8,912  | (57)  | 8,855         |
| <b>Current Assets sub-total</b>                              | <b>19,969</b>                |     | <b>1,048</b>        | <b>21,017</b>  | <b>(554)</b>  | <b>20,463</b> |
| <b>Discontinued operations/assets held for sale:</b>         |                              |     |                     |  |   |               |
| of a financial nature  |                              | (*) |                     |  | 84  | 84            |
| of a non-financial nature                                    |                              |     |                     |  | 1,096   | 1,096         |
|  |                              |     |                     |  | <b>1,180</b>  | <b>1,180</b>  |

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|  |               |              |               |               |               |               |
|--|---------------|--------------|---------------|---------------|---------------|---------------|
| <b>TOTAL CURRENT ASSETS (B)</b>  | <b>19,969</b> | <b>1,048</b> | <b>21,017</b> | <b>626</b>    | <b>21,643</b> |               |
| <b>TOTAL ASSETS (A+B)</b>  | <b>76,609</b> | <b>5,049</b> | <b>81,658</b> | <b>176</b>    | <b>81,834</b> |               |
| <b>SHAREHOLDERS EQUITY</b>   |               |              |               |               |               |               |
| Attributable to the Group  | 15,172        | 1,076        | 16,248        |               | 16,248        |               |
| Attributable to Minority interests   | 4,689         | (139)        | 4,550         |               | 4,550         |               |
| <b>TOTAL SHAREHOLDERS EQUITY (C)</b>   | <b>19,861</b> | <b>937</b>   | <b>20,798</b> |               | <b>20,798</b> |               |
| <b>Non-current liabilities:</b>  |               |              |               |               |               |               |
| Non-current financial liabilities  | 36,937        | (*)          | 1,889         | 38,826        | (101)         | 38,725        |
| Employee severance indemnities and other employee-related reserves                 | 1,369         | m)           | (77)          | 1,292         | (70)          | 1,222         |
| Reserve for deferred taxes   | 225           | n)           | (51)          | 174           | (4)           | 170           |
| Reserves for risks and future charges  | 831           | o)           |               | 831           | (16)          | 815           |
| Miscellaneous payables and other non-current liabilities                           | 1,458         | p)           | 746           | 2,204         | (5)           | 2,199         |
| <b>TOTAL NON-CURRENT LIABILITIES (D)</b>   | <b>40,820</b> |              | <b>2,507</b>  | <b>43,327</b> | <b>(196)</b>  | <b>43,131</b> |
| <b>Current Liabilities:</b>  |               |              |               |               |               |               |
| Current financial liabilities  | 3,393         | (*)          | 1,061         | 4,454         | (54)          | 4,400         |
| Trade payables, tax payables, miscellaneous payables and other current liabilities | 12,535        | q)           | 544           | 13,079        | (346)         | 12,733        |
| <b>Current Liabilities sub-total</b>   | <b>15,928</b> |              | <b>1,605</b>  | <b>17,533</b> | <b>(400)</b>  | <b>17,133</b> |
| <b>Liabilities relating to discontinued operations/assets held for sale:</b>       |               |              |               |               |               |               |
| of a financial nature  |               | (*)          |               |               | 188           | 188           |
| of a non-financial nature  |               |              |               |               | 584           | 584           |
|  |               |              |               |               | <b>772</b>    | <b>772</b>    |
| <b>TOTAL CURRENT LIABILITIES (E)</b>   | <b>15,928</b> |              | <b>1,605</b>  | <b>17,533</b> | <b>372</b>    | <b>17,905</b> |
| <b>TOTAL LIABILITIES (F=D+E)</b>   | <b>56,748</b> |              | <b>4,112</b>  | <b>60,860</b> | <b>176</b>    | <b>61,036</b> |
| <b>TOTAL SHAREHOLDERS EQUITY AND LIABILITIES (C+F)</b>                             | <b>76,609</b> |              | <b>5,049</b>  | <b>81,658</b> | <b>176</b>    | <b>81,834</b> |

(^) The balance sheet data has been prepared in accordance with IFRS in force at December 31, 2005.

(\*) Item included in net financial debt.

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## CONSOLIDATED STATEMENT OF INCOME FOR THE YEAR ENDED DECEMBER 31, 2004 (^)

|  | Italian<br>GAAP<br>reclassified |    | IFRS<br>adjustments | IFRS<br>including<br>discontinued<br>operations<br><br>/assets<br><br>held for<br>sale | Discontinued<br>operations /<br>assets held<br>for sale<br>Finsiel<br><br>group<br>Corporacion<br>Digitel | IFRS          |
|--|---------------------------------|----|---------------------|--|---|---------------|
| (millions of Euro)   |                                 |    |                     |  |   |               |
| Revenues   | 31,231                          | a) | (146)               | 31,085   | (795)   | 30,290        |
| Other income   | 1,158                           | b) | (30)                | 1,128  | (23)  | 1,105         |
| <b>Total operating revenues and other income</b>                                 | <b>32,389</b>                   |    | <b>(176)</b>        | <b>32,213</b>  | <b>(818)</b>  | <b>31,395</b> |
| Purchases of materials and external services                                     | (13,339)                        | c) | (109)               | (13,448)   | 437   | (13,011)      |
| Personnel costs  | (4,285)                         | d) | (5)                 | (4,290)  | 278   | (4,012)       |
| Other operating expenses   | (1,684)                         | e) | (43)                | (1,727)  | 33  | (1,694)       |
| Changes in inventories   | 31                              |    | (1)                 | 30   | (1)   | 29            |
| Capitalized internal construction costs  | 742                             |    | (4)                 | 738  | (21)  | 717           |
| Depreciation and amortization  | (6,646)                         | f) | 1,451               | (5,195)  | 61  | (5,134)       |
| Gains/losses realized on non-current assets (l)                                  | (10)                            |    | (2)                 | (12)   | 1   | (11)          |
| Impairment losses /reversals on disposal of<br>non-current assets                | (641)                           | g) | (21)                | (662)  | 27  | (635)         |
| <b>OPERATING INCOME</b>  | <b>6,557</b>                    |    | <b>1,090</b>        | <b>7,647</b>   | <b>(3)</b>  | <b>7,644</b>  |
| Share of earnings of equity investments<br>accounted for using the equity method | (11)                            |    | 8                   | (3)  | (1)   | (4)           |
| Financial income   | 1,705                           | h) | 553                 | 2,258  | (35)  | 2,223         |
| Financial expenses   | (3,408)                         | h) | (911)               | (4,319)  | 51  | (4,268)       |
| <b>INCOME FROM CONTINUING OPERATIONS<br/>BEFORE TAXES</b>                        | <b>4,843</b>                    |    | <b>740</b>          | <b>5,583</b>   | <b>12</b>   | <b>5,595</b>  |
| Income taxes   | (2,941)                         | i) | 192                 | (2,749)  | 30  | (2,719)       |
| <b>NET INCOME FROM CONTINUING<br/>OPERATIONS</b>                                 | <b>1,902</b>                    |    | <b>932</b>          | <b>2,834</b>   | <b>42</b>   | <b>2,876</b>  |
| Net income (loss) from discontinued<br>operations/assets held for sale           |                                 |    |                     |  | (42)  | (42)          |
| <b>NET INCOME</b>  | <b>1,902</b>                    |    | <b>932</b>          | <b>2,834</b>   |   | <b>2,834</b>  |
| <i>Of which:</i>   | 781                             |    | 1,034               | 1,815  |   | 1,815         |
|  | 1,121                           |    | (102)               | 1,019  |   | 1,019         |

\* *Net income attributable to the Group*

\* *Net income attributable to Minority interests*

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(^) The statement of operations data has been prepared in accordance with IFRS in force at December 31, 2005.

(l) Excludes capital gains/losses realized on the sale of equity investments classified as discontinued operations/assets held for sale and equity investments other than in subsidiaries.

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**COMMENTS TO THE PRINCIPAL IFRS ADJUSTMENTS MADE TO THE BALANCE SHEETS AS OF JANUARY 1, 2004 AND DECEMBER 31, 2004 AND THE STATEMENT OF OPERATIONS FOR THE YEAR 2004**

Information on the principal adjustments is presented below with brief comments and references to the adjustments presented in the reconciliations of shareholders' equity and net income, previously illustrated.

The effects of the changes relating to the financial assets and liabilities included in the net financial position are presented in the relative reconciliation.

***Adjustments to the consolidated balance sheet Assets***

- a) *goodwill and other intangible assets with an indefinite life*; these adjustments refer to:
- at January 1, 2004 (an increase of 327 million) recognition of additional goodwill following the consolidation of TIM shares classified in accordance with Italian GAAP in current assets (see adjustment No. 2);
  - at December 31, 2004 (an increase of 1,978 million) principally the reversal of amortization of goodwill of 1,554 million (see adjustment No. 1), recognition of additional goodwill of 149 million on consolidation of the aforementioned TIM shares classified in accordance with Italian GAAP in current assets, and goodwill of 295 million for the acquisition of TIM shares under the irrevocable purchase commitment connected with the put/call option (see adjustment No. 2);
- b) *intangible assets with a finite life*; these adjustments (a decrease of 86 million at January 1, 2004 and a decrease of 61 million at December 31, 2004) principally regard the derecognition of certain start-up and expansion costs which do not meet the requirements under IFRS for recognition in intangible assets (see adjustment No. 13);
- c) *property, plant and equipment owned*; these adjustments ( 253 million at January 1, 2004 and an increase of 162 million at December 31, 2004) principally regard:
- the elimination of the accumulated depreciation of land pertaining to buildings, equal to 84 million at January 1, 2004 and 91 million at December 31, 2004, which must be separated from the buildings and no longer depreciated, in accordance with IFRS (see adjustment No. 11);
  - the capitalization of restoration costs of 213 million at January 1, 2004 and 263 million at December 31, 2004 (see adjustment No. 15);
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the elimination of intragroup gains on tangible assets produced within the Group with the consequent decrease in the amount of these same assets of 60 million at January 1, 2004 and 83 million at December 31, 2004 (see adjustment No. 14);

- the elimination of monetary revaluations made to tangible assets of the Entel Chile group of 25 million at December 31, 2004;

d) *assets held under finance leases* (an increase of 1,433 million at January 1, 2004 and an increase of 1,446 million at December 31, 2004); these adjustments principally regard:

- the recognition of 1,363 million at January 1, 2004 and 1,282 million at December 31, 2004, in non-current assets of buildings subject to sale and leaseback transactions in prior years since they have the characteristics of finance leases (see adjustment No. 4);
- the recognition of 70 million at January 1, 2004 and 58 million at December 31, 2004, in non-current assets of tangible assets under finance lease contracts;

e) *equity investments (non-current)* (a decrease of 427 million at January 1, 2004 and a decrease of 374 million at December 31, 2004); these adjustments principally regard:

- the reversal of treasury stock of 393 million at January 1, 2004 and at December 31, 2004, which is accounted for as a reduction of shareholders' equity in accordance with IFRS (see adjustment No. 8);
- the adjustment to fair value of equity investments in companies other than subsidiaries and associates of 15 million at January 1, 2004 and 55 million at December 31, 2004 (see adjustment No. 16);

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- f) *miscellaneous receivables and other non-current assets* (an increase of 460 million at January 1, 2004 and an increase of 568 million at December 31, 2004); these adjustments principally regard:
- the recognition of prepaid expenses related to the deferral of costs associated with the recognition of revenues (see adjustment No. 9) of 560 million at January 1, 2004 and 496 million at December 31, 2004;
  - the reversal of expenses on notes and bonds as a result of the application of the amortized cost method to financial liabilities of 136 million at January 1, 2004 and 107 million at December 31, 2004;
  - the recognition at fair value of derivative financial instruments (see adjustments Nos. 7 and 16) of 67 million at January 1, 2004 and 60 million at December 31, 2004;
- g) *deferred tax assets* (an increase of 243 million at January 1, 2004 and an increase of 455 million at December 31, 2004); these adjustments regard the contra-entry in assets of the tax effect on the items in reconciliation as well as the recognition of deferred tax assets that were not recorded under Italian GAAP because the requirement of reasonable certainty was not met (see adjustment No. 10);
- h) *inventories* (an increase of 3 million at January 1, 2004 and an increase of 1 million at December 31, 2004); these adjustments principally regard the adoption of the weighted average cost method;
- i) *trade and miscellaneous receivables and other current assets* (an increase of 1,201 million at January 1, 2004 and an increase of 1,412 million at December 31, 2004); these adjustments principally regard:
- the re-recognition of trade receivables and miscellaneous receivables sold through factoring transactions that are not recognized under IFRS (see adjustment No. 3) of 351 million at January 1, 2004 and 760 million at December 31, 2004;
  - the re-recognition of trade receivables sold through securitization transactions that are not recognized under IFRS (see adjustment No. 2) of 799 million at January 1, 2004 and 728 million at December 31, 2004;
- l) *equity investments* (a decrease of 166 million at January 1, 2004); this adjustment regards the reversal of TIM shares, following their consolidation, recorded in accordance with Italian GAAP in current assets (see adjustment No. 2).

**Adjustments to the consolidated balance sheet Liabilities**

- m) *employee severance indemnities and other employee-related reserves* (a decrease of 102 million at January 1, 2004 and a decrease of 77 million at December 31, 2004); these adjustments mainly regard the application of actuarial methods to employee severance indemnities;
- n) *reserve for deferred taxes* (an increase of 3 million at January 1, 2004 and a decrease of 51 million at December 31, 2004); these adjustments regard the contra-entry in liabilities for the tax effect on items in reconciliation;



- o) *reserves for risks and future charges* (a decrease of 243 million at January 1, 2004 and no impact at December 31, 2004); these adjustments principally regard:
- the derecognition of certain reserves due to the absence of the requirements necessary for their recognition (actual, legal or constructive obligation) of 276 million at January 1, 2004 and 68 million at December 31, 2004;
  - the provision to the reserve for restoration costs (see adjustment No. 15) of 281 million at January 1, 2004 and 378 million at December 31, 2004;
  - the reclassification to financial liabilities of the portion of the repayment premium due on the exchangeable notes Telecom Italia Finance 2001-2006 of 218 million at January 1, 2004 and 264 million at December 31, 2004;
- p) *miscellaneous payables and other non-current liabilities* (an increase of 706 million at January 1, 2004 and an increase of 746 million at December 31, 2004); these adjustments principally regard deferred income for the deferral of the revenues on the activation of Telecom Italia telephone service;

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- q) *trade payables, tax payables, miscellaneous payables and other current liabilities* (an increase of 244 million at January 1, 2004 and an increase of 544 million at December 31, 2004); these adjustments principally regard deferred income for the deferral of revenues on the activation of Telecom Italia telephone service and revenues on the recharge of TIM prepaid cards.

**Adjustments to the consolidated statement of operations for the year 2004**

- a) *revenues* (a decrease of 146 million): principally regard the deferral of revenues on the activation of telephone service and the recharge of prepaid telephone cards over the estimated duration of the relationship with the customer (see adjustment No. 9);
- b) *other income* (a decrease of 30 million): this adjustment principally regards the derecognition of the reserves for risks and charges which do not meet the requirements under IFRS for recognition (see adjustment No. 5);
- c) *purchases of materials and external services* (an increase of 109 million): these adjustments principally regard:
- as a decrease, the reversal of financial lease payments relating to the sale and leaseback transactions on buildings, equal to 187 million (see adjustment No. 4), and to financial lease transactions on tangible assets, equal to 32 million;
  - as an increase, the reversal of 224 million, of the release of certain reserves for risks and future charges (not recognized under IFRS) recorded in the statement of operations in the year 2004 under Italian GAAP (see adjustment No. 5) and the effect of deferring the costs related to the revenues for the activation of telephone service and the recharge of prepaid cards for an increase of 113 million (see adjustment No. 9);
- d) *personnel costs* (an increase of 5 million): these adjustments principally regard the higher provision to the reserve for employee severance indemnities of 18 million, and the increase in the principal amount of the payable relating to Law No. 58/92 of 9 million, and the decrease for the reversal of personnel costs related to the deferral of revenues for the activation of telephone service and the recharge of prepaid cards, of 22 million (see adjustment No. 9);
- e) *other operating expenses* (an increase of 43 million): these adjustments principally regard the higher expenses consequent to the consolidation of the special purpose entity, TISV, set up for securitization transactions (see adjustment No. 2);
- f) *depreciation and amortization* (a decrease of 1,451 million): these adjustments principally reflect:
- as a decrease, the reversal of 1,559 million for goodwill amortization (see adjustment No. 1), lower depreciation of 26 million, in connection with the elimination of intragroup gains (see adjustment No. 14) and the reversal of depreciation of 6 million relating to the land pertaining to the buildings (see adjustment No. 11);
  - as an increase, the recognition of the depreciation charge of 81 million on buildings that were the subject of a sale and leaseback under finance lease contracts (see adjustment No. 4); 40 million for the depreciation charge on

other finance leases and 5 million for the depreciation charge on restoration costs;

- g) *impairment losses of non-current assets* (an increase of 21 million): these adjustments principally regard the impairment of the difference on consolidation relating to Entel Chile to bring the carrying amount in line with the sales amount;
- h) *net financial expense* (an increase of 358 million): these adjustments principally regard the recognition of financial expenses of 197 million included in finance lease payments for the sale and leaseback of properties (see adjustment No. 4), the recognition of higher financial expenses of 83 million, consequent to the application of the amortized cost method to convertible and exchangeable notes and bonds (see adjustment No. 6), the elimination of impairment reversals of 32 million, and dividends of 10 million, relating to the shares of consolidated companies classified according to Italian GAAP in current assets;
- i) *income taxes for the year* (a decrease of 192 million): this decrease includes 242 million relating to the positive net tax effect on the above-described adjustments offset by deferred tax assets of 50 million recorded in the Italian GAAP 2004 financial statements but already included in the IFRS financial statements at January 1, 2004 (see adjustment No. 10).

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The Consolidated Financial Statements of the Group have been prepared in accordance with IFRS, which differ in certain respects from generally accepted accounting principles in the United States (U.S. GAAP).

Application of U.S. GAAP would have affected net profit for each of the years ended December 31, 2004 and 2005 and shareholders' equity as of December 31, 2004 and 2005 to the extent described below.

|  | <b>Year ended<br/>December 31,</b> |              |
|--|------------------------------------|--------------|
|  | <b>2004</b>                        | <b>2005</b>  |
|  | <b>(millions of Euro)</b>          |              |
| <b>RECONCILIATION OF NET INCOME FROM IFRS TO U.S. GAAP</b>                         |                                    |              |
| Net income as reported in the consolidated statements of operations                | 2,834                              | 3,690        |
| Minority interests   | (1,019)                            | (474)        |
| <b>Net income attributable to the Group under IFRS</b>                             | <b>A) 1,815</b>                    | <b>3,216</b> |
| <b>U.S. GAAP reconciling adjustments:</b>  |                                    |              |
| 1. Business combinations prior to the adoption of IFRS:                            |                                    |              |
| (a) Goodwill and other intangible assets with an indefinite life                   |                                    |              |
| (b) Other intangible assets  | (1,026)                            | (824)        |
| (c) Tangible assets  | 48                                 | (402)        |
| (d) Other  | 136                                | 253          |
|  | (842)                              | (973)        |
| 2. Purchase method of accounting related to TIM Acquisition in 2005:               |                                    |              |
| (a) Goodwill and other intangible assets with an indefinite life                   |                                    |              |
| (b) Other intangible assets  |                                    | (529)        |
| (c) Other  |                                    | (163)        |
|  |                                    | (692)        |
| 3. Purchase method of accounting for other transactions after the adoption of IFRS |                                    | (22)         |
| 4. Reversal of revaluation on tangible assets                                      | 7                                  | 85           |
| 5. Reversal of goodwill amortization and goodwill impairment                       | 438                                | (8)          |
| 6. Capitalization of interest  | (60)                               | (26)         |
| 7. Sale of real estate properties  | 44                                 | (44)         |
| 8. Common control transactions   |                                    |              |
| 9. Convertible notes/bonds   | 28                                 | 12           |
| 10. Deferred taxes on tax-suspension equity reserves                               |                                    | (57)         |
| 11. Other  | (37)                               | (9)          |
|  | 420                                | (69)         |

|   |                     |                   |                   |
|---|---------------------|-------------------|-------------------|
| <b>Total U.S. GAAP reconciling adjustments</b>  | <b>B)</b>           | <b>(422)</b>      | <b>(1,734)</b>    |
| <b>Tax effect on reconciling items</b>  | <b>C)</b>           | <b>334</b>        | <b>558</b>        |
| <b>Minority interests on reconciling items</b>  | <b>D)</b>           | <b>(186)</b>      | <b>27</b>         |
| <b>Total effect of discontinued operations/assets held for sale</b>                       | <b>E)</b>           |                   | <b>(175)</b>      |
| <b>Cumulative effect of accounting changes, net of taxes and after Minority interests</b> | <b>F)</b>           |                   | <b>47</b>         |
|   |                     | <u>          </u> | <u>          </u> |
| <b>Net income in accordance with U.S. GAAP</b>  | <b>A+B+C+D+E+F)</b> | <b>1,541</b>      | <b>1,939</b>      |
|   |                     | <u>          </u> | <u>          </u> |

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|   |                   | As of<br>December 31, |                |
|---|-------------------|-----------------------|----------------|
|   |                   | 2004                  | 2005           |
|   |                   | (millions of Euro)    |                |
| <b>RECONCILIATION OF SHAREHOLDERS EQUITY FROM IFRS TO U.S. GAAP</b>                         |                   |                       |                |
| Shareholders Equity as reported in the consolidated balance sheets                          |                   | 20,798                | 26,985         |
| Minority interests  |                   | (4,550)               | (1,323)        |
| <b>Shareholders Equity attributable to the Group under IFRS</b>                             | <b>A)</b>         | <b>16,248</b>         | <b>25,662</b>  |
| <b>U.S. GAAP reconciling adjustments:</b>   |                   |                       |                |
| 1. Business combinations prior to the adoption of IFRS:                                     |                   |                       |                |
| (a) Goodwill and other intangible assets with an indefinite life                            |                   | 12,755                | 12,755         |
| (b) Other intangible assets   |                   | 10,300                | 9,476          |
| (c) Tangible assets   |                   | 925                   | 523            |
| (d) Other   |                   | (415)                 | (162)          |
|   |                   | 23,565                | 22,592         |
| 2. Purchase method of accounting related to TIM Acquisition in 2005:                        |                   |                       |                |
| (a) Goodwill and other intangible assets with an indefinite life                            |                   |                       | (4,115)        |
| (b) Other intangible assets   |                   |                       | 7,030          |
| (c) Other   |                   |                       | 160            |
|   |                   |                       | 3,075          |
| 3. Purchase method of accounting for other transactions occurred after the adoption of IFRS |                   |                       |                |
|   |                   |                       | 346            |
| 4. Reversal of revaluation on tangible assets   |                   | (377)                 | (284)          |
| 5. Reversal of goodwill amortization and goodwill impairment                                |                   | 748                   | 708            |
| 6. Capitalization of interest   |                   | 786                   | 752            |
| 7. Sale of real estate properties   |                   | (171)                 | (215)          |
| 8. Common control transactions  |                   | (169)                 | (169)          |
| 9. Convertible notes/bonds  |                   | (378)                 | (67)           |
| 10. Deferred taxes on tax-suspension equity reserves  |                   | (200)                 | (257)          |
| 11. Other   |                   | 197                   | 125            |
| 12. Discontinued operations/assets held for sale  |                   | (61)                  | (55)           |
|   |                   | 375                   | 884            |
| <b>Total U.S. GAAP reconciling adjustments</b>  | <b>B)</b>         | <b>23,940</b>         | <b>26,551</b>  |
| <b>Tax effect on reconciling items</b>  | <b>C)</b>         | <b>(4,979)</b>        | <b>(7,559)</b> |
| <b>Minority interests on reconciling items</b>  | <b>D)</b>         | <b>(335)</b>          | <b>(23)</b>    |
| <b>Cumulative effect of accounting changes, net of taxes and after Minority interests</b>   | <b>E)</b>         | <b>(47)</b>           |                |
| <b>Shareholders Equity in accordance with U.S. GAAP</b>                                     | <b>A+B+C+D+E)</b> | <b>34,827</b>         | <b>44,631</b>  |

**1. BUSINESS COMBINATIONS PRIOR TO THE ADOPTION OF IFRS**

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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, 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). In accordance with Statement of Financial Accounting Standards ( **SFAS** ) 141, *Business Combinations*, U.S. GAAP requires that an acquirer be determined, the fair value of the consideration exchanged be accounted for (including outstanding vested stock options of the acquired company) and the assets and liabilities purchased be recorded at fair value for all business combinations.

Goodwill recognized in business combinations in periods prior to the first-time adoption of IFRS has been recorded in the opening IFRS balance sheet at the carryover values determined on the basis of Italian GAAP. The carrying value of such was subject to an impairment test at January 1, 2004, which did not result in the recognition of impairment charges.

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During 2005, the Group has recorded additional expense for U.S. GAAP purposes related to the real estate assets disposed of in 2005 (see Note 43.7 below, Magnum Project) in the amount of 366 million.

**2. PURCHASE METHOD OF ACCOUNTING RELATED TO TIM ACQUISITION IN 2005**

In accordance with the parent-entity extension method, the purchase consideration in excess of the carrying amount of a minority interest acquired is recorded as goodwill under IFRS. Under U.S. GAAP, in accordance with SFAS 141, the acquisition of minority interests is accounted for using the purchase method, and the difference between the fair value of the purchase consideration and the fair value of the Group's share of assets and liabilities acquired is recorded as goodwill.

During 2005, the Group acquired the outstanding minority interest in TIM as described in Note 4 Business Combinations, Acquisitions on Minority Interests and Transactions between Companies under Common Control, resulting in goodwill in the amount of 16,654 million under IFRS. For U.S. GAAP purposes the purchase price allocation resulted in the recognition of goodwill of 12,020 million, intangible assets of 8,276 million, consisting mainly of customer list and brand name. The customer base of approximately 6,200 million will be amortized over approximately 12 years, while the brand name has been assigned an indefinite life and will be subject to annual impairment testing.

**3. PURCHASE METHOD OF ACCOUNTING FOR OTHER TRANSACTIONS OCCURRED AFTER THE ADOPTION OF IFRS**

As described in Note 4 Business Combinations, Acquisitions on Minority Interests and Transactions between Companies under Common Control, 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 goodwill was attributed to the reporting unit Wireline.

**4. REVERSAL OF REVALUATION ON TANGIBLE ASSETS**

In prior years, under the previous accounting principles (Italian GAAP), the Group revalued certain tangible assets as required or permitted by specific regulations. As allowed by the IFRS first time adoption, as of January 1, 2004, the Group elected to use, for certain assets then existing, the revalued cost at the revaluation date as deemed cost.

U.S. GAAP does not permit revaluation of tangible assets and requires depreciation based on historical acquisition cost. Consequently, such different accounting treatment resulted in an increase in net income, due to the reversal to the statement of operations of the depreciation charge of the year, and a reduction in net shareholders' equity due to the reversal of the portion of revaluation not yet depreciated.



## 5. REVERSAL OF GOODWILL AMORTIZATION AND GOODWILL IMPAIRMENT

Under IFRS goodwill is no longer amortized starting from January 1, 2004 (the transition date to IFRS), whereas it was amortized over the asset's estimated economic life under previous accounting principles (Italian GAAP). As permitted by IFRS 1, the carrying value of goodwill under Italian GAAP as of December 31, 2003 was reviewed for impairment and carried forward in the opening balance sheet as of January 1, 2004.

Under U.S. GAAP, upon the adoption of SFAS 142, *Goodwill and Other Intangible Assets*, on January 1, 2002, the Group ceased amortizing goodwill.

Both under IFRS and U.S. GAAP goodwill is tested for impairment annually or more frequently if specific events or changes in circumstances indicate that the goodwill may be impaired; impairment losses of goodwill are not reversed. Under IFRS, to test for impairment, goodwill is allocated, at the date of acquisition, to each cash-generating unit or group of cash-generating units which are expected to benefit from the acquisition. Allocation

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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 goodwill is assessed for impairment at least annually. If indicators of impairment exist during the year, then an impairment review is conducted before the annual review. 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 fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered impaired and the second part of the test is not considered necessary. 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.

**6. 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. The Group capitalized interest expenses of 57 million and 114 million in 2004 and 2005, respectively.

**7. SALE OF REAL ESTATE PROPERTIES**

Through 2005, the Group entered into a series of real estate transactions that involved IM.SER, Tiglio I, Tiglio II, Pirelli and other Group related parties.

Under IFRS such transactions have been recorded in accordance with the finance method in that the present value of the contractually provided payments approximates the fair value of the properties under lease, except for land which, in absence of a contractual favorable purchase option, was treated as an operating lease.

Such accounting treatment was also followed under U.S. GAAP except for lease contracts relating to land which were generally treated as finance leases.

Furthermore, during 2005, Telecom Italia carried out a series of transactions in the context of the reorganization of the physical space occupied by network equipment to gradually free part of the buildings used for such equipment. Such project ( **Magnum Project** ) involves the sale of more than 1,300 properties for a total amount of approximately 1 billion. Accordingly, in December 2005, the Group transferred 807 properties for a value of 663 million to certain closed-end real estate investment funds. Pirelli & C.

Real Estate S.p.A., a related party, has a 35% investment in these funds. Under IFRS, these transactions generated a capital gain, net of incidental charges, for the Group of 264 million. For further details see Note 8 Tangible Assets (Owned and under Finance Leases) and Note 45 Additional U.S. GAAP Disclosures Subsequent Events.

Under U.S. GAAP such transactions resulted in a loss on some properties due to the higher book value that resulted from the purchase price allocation in prior years. The reduction in the purchase price adjustment for the real estate assets of 366 million results in a reduction in the adjustment described in note 43. 1 above. In addition, SFAS 13 *Accounting for leases* ( SFAS 13 ) requires that in a sale-leaseback transaction with a lease classified as an operating lease, any profit or loss on the sale shall be deferred and amortized in proportion to the rental payments over the period of time that the asset is expected to be used. Under IAS 17 *Leases* , the profit corresponding to the disposal of the asset is not deferred if the transaction was made with a selling price and rental payments correspond to the market conditions at the time of the transaction. As a result, the gain on sale on certain properties has been deferred over the life of the lease contract in accordance with the requirements of SFAS 13 *Accounting for Leases* , resulting in a reduction of pre-tax income of 27 million.

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**8. COMMON CONTROL TRANSACTIONS**

During 2000, Telecom Italia acquired an additional ownership percentage in TIM by contributing its ownership of SMH (renamed TIM International) to TIM in exchange for new shares issued by TIM. Under the previous accounting principles (Italian GAAP), this transaction resulted in an increase in equity and goodwill. Such accounting treatment was retained under IFRS in accordance with IFRS first time adoption.

Under U.S. GAAP, transactions between entities under common control require predecessor basis accounting. Therefore, the increase in equity and goodwill has been reversed, along with the related goodwill amortization.

**9. 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 and an increase in liabilities.

**10. DEFERRED TAXES ON TAX-SUSPENSION EQUITY RESERVES**

For U.S. GAAP reporting purposes, the Group follows the provisions of SFAS 109, *Accounting for Income Taxes*. In accordance with SFAS 109, the Group has recognized deferred tax assets and liabilities based on the difference between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect in the years when those temporary differences are expected to reverse. The effect on the deferred taxes of changes in tax rates is recognized in income in the period that includes the enactment date. Where it is more likely than not that all or a portion of a deferred tax asset will not be realized, a valuation allowance has been recorded against it in order to reduce the deferred tax asset to the amount that is more likely than not to be realized.

No provision has been made for Italian taxes or foreign taxes that may result from future remittances of undistributed earnings of foreign subsidiaries, as it is expected that all such earnings will be permanently reinvested in these foreign operations. It is not practical to estimate the amount of taxes that might be payable on the eventual remittance of these earnings due to the complexities associated with its hypothetical calculation.

In connection with acquisitions in prior years, a portion of net operating losses carry-forwards of the Group were covered by a valuation allowance at the date of acquisition. If these assets are subsequently recognized, the tax benefit will reduce goodwill and other non current intangible assets.

Under IFRS, IAS 12 *Income taxes*, allows, under certain conditions, for deferred income taxes on tax suspension equity reserves not to be recorded, whereas, under U.S. GAAP, SFAS 109 *Accounting for Income Taxes* provides that deferred taxes, in any case, shall be provided.

The valuation allowance amounts to 1,850 million in 2005 with an increase of 391 million compared with the previous year. The valuation allowance is recorded because it is more likely than not that certain net operating losses will not be utilized.

## 11. OTHER

Other mainly comprises the following:

- **REVERSAL OF CURRENCY TRANSLATION ADJUSTMENT ON GOODWILL**

In accordance with IFRS, goodwill allocated to the Brazilian Mobile cash generating unit (expressed in a currency different from the Euro) as of December 31, 2005, was adjusted to the Real/Euro spot exchange rate at that date.

Under U.S. GAAP this adjustment has been reversed since goodwill arising from TIM minorities acquisition (see Note 43.2 Purchase Method of Accounting related to TIM Acquisition in 2005) was allocated to the Mobile reporting unit as a whole.

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- **IMPAIRMENT OF TANGIBLE AND INTANGIBLE ASSETS**

Under U.S. GAAP, the Group follows the guidance provided in SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* to evaluate and account for impairments of depreciable assets or assets to be disposed of. Such statement provides that carrying values shall be firstly compared with undiscounted cash flows; as a result of this analysis certain impairment losses recorded under IFRS were deemed not necessary under U.S. GAAP and therefore have been reversed.

- **RESERVE FOR TERMINATION INCENTIVES**

Under U.S. GAAP, in accordance with SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities* and SFAS 88, *Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, certain conditions must be met before a restructuring accrual can be established. Therefore, part of the accruals recorded for IFRS purposes were reversed under U.S. GAAP.

- **DERIVATIVES FINANCIAL INSTRUMENTS**

Under IFRS, the Group treats the call option in Sofora as a derivative instrument which is valued at fair value at the end of each reporting period as described in Note 9-Other Non-Current Assets. Under U.S. GAAP, the call option does not meet the definition of a derivative instrument under SFAS 133 *Accounting for Derivative Instruments and Hedging Activities* and has been accounted for based at cost subject to review for impairment.

- **ASSET RETIREMENT OBLIGATIONS**

The Group capitalizes asset retirement costs and records a liability for the present value of the obligation at the inception of the retirement obligation under both IFRS and U.S. GAAP. IFRS requires that adjustments are made to the asset retirement obligation and the related cost to reflect changes in discount rates. This results in differences in accretion expense of the retirement obligations and depreciation expense of the asset retirement costs between IFRS and U.S. GAAP.

- **PRESENT VALUE ADJUSTMENTS**

Under IFRS, liabilities are recorded at their present value. Under U.S. GAAP, liabilities with maturities exceeding one year are recorded at their present value only when required by a specific accounting standard.

**12. DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE**

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Under U.S. GAAP, Telecom Italia identifies discontinued operations under the framework established by SFAS 144 which is similar to the framework of IFRS 5 except as it relates to balance sheet presentation for comparative purposes. Under IFRS, only the comparative information for the statement of operations is restated. While for U.S. GAAP, the comparative balance sheet shows the assets and liabilities of operations which were discontinued or sold on the current period separately. In 2005, an additional charge of 180 million was recorded under U.S. GAAP as a result of the reclassification to the statement of operations of the amount of cumulative translation adjustments recorded prior to the date of adoption of IFRS. Under IFRS, the Group transferred the cumulative translation reserve to other equity reserves as permitted by IFRS 1 on the first adoption date.

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**NOTE 44 CONDENSED CONSOLIDATED U.S. GAAP FINANCIAL STATEMENTS**

The condensed consolidated financial statements as of December 31, 2004 and 2005 and for the years ended December 31, 2004 and 2005 presented below have been prepared to reflect the principal differences between the Telecom Italia Group's accounting policies and U.S. GAAP discussed above.

**CONDENSED CONSOLIDATED BALANCE SHEETS**

IN ACCORDANCE WITH U.S. GAAP AS OF DECEMBER 31, 2004 AND 2005

|   | As of December 31, |                |
|---|--------------------|----------------|
|   | 2004               | 2005           |
|   | (millions of Euro) |                |
| <b>ASSETS</b>   |                    |                |
| <b>NON-CURRENT ASSETS:</b>  |                    |                |
| Goodwill and other intangible assets with an indefinite life                                    | 39,736             | 53,168         |
| Intangible assets with a finite life  | 17,257             | 23,980         |
| Tangible assets   | 19,191             | 19,196         |
| Other non-current assets and deferred tax assets:   |                    |                |
| • Deferred tax assets   | 1,522              | 489            |
| • Other   | 2,424              | 3,299          |
| <b>TOTAL NON-CURRENT ASSETS</b>   | <b>80,130</b>      | <b>100,132</b> |
| <b>TOTAL CURRENT ASSETS, EXCLUDING DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE</b>             | <b>21,983</b>      | <b>22,698</b>  |
| <b>TOTAL DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE</b>                                       | <b>4,806</b>       | <b>474</b>     |
| <b>TOTAL ASSETS</b>   | <b>106,919</b>     | <b>123,304</b> |
| <b>SHAREHOLDERS EQUITY AND LIABILITIES</b>  |                    |                |
| <b>SHAREHOLDERS EQUITY</b>  | 34,827             | 44,631         |
| <i>of which share capital</i>   | 8,809              | 10,599         |
| <b>MINORITY INTERESTS</b>   | <b>4,886</b>       | <b>1,346</b>   |
| <b>NON-CURRENT LIABILITIES:</b>   |                    |                |
| Non-current financial liabilities   | 38,725             | 43,065         |
| Employee severance indemnities and other employee-related reserves                              | 1,280              | 1,273          |
| Reserve for deferred taxes  | 5,232              | 7,796          |
| Reserves for risks and future charges, miscellaneous payables and other non-current liabilities | 3,514              | 2,804          |
| <b>TOTAL NON-CURRENT LIABILITIES</b>  | <b>48,751</b>      | <b>54,938</b>  |



|  |                   |                   |
|--|-------------------|-------------------|
| <b>CURRENT LIABILITIES:</b>  |                   |                   |
| Current financial liabilities  | 4,449             | 9,778             |
| Trade payables, tax payables, miscellaneous payables and other current liabilities                               | 11,668            | 12,326            |
|  | <u>          </u> | <u>          </u> |
| <b>TOTAL CURRENT LIABILITIES, EXCLUDING LIABILITIES RELATING TO DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE</b> | <b>16,117</b>     | <b>22,104</b>     |
|  | <u>          </u> | <u>          </u> |
| <b>TOTAL LIABILITIES RELATING TO DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE</b>                                | <b>2,338</b>      | <b>285</b>        |
|  | <u>          </u> | <u>          </u> |
| <b>TOTAL LIABILITIES(*)</b>  | <b>72,092</b>     | <b>78,673</b>     |
|  | <u>          </u> | <u>          </u> |
| <b>TOTAL SHAREHOLDERS EQUITY AND LIABILITIES</b>   | <b>106,919</b>    | <b>123,304</b>    |
|  | <u>          </u> | <u>          </u> |

(\*) Includes Minority interests.

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**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS IN ACCORDANCE WITH****U.S. GAAP FOR THE YEARS ENDED DECEMBER 31, 2004 AND 2005**

|   | Year ended<br>December 31, |               |
|---|----------------------------|---------------|
|   | 2004                       | 2005          |
|   | (millions of Euro)         |               |
| Revenues  | 28,292                     | 29,921        |
| Other income  | 1,080                      | 670           |
| <b>Total operating revenues and other income</b>  | <b>29,372</b>              | <b>30,591</b> |
| Total operating expenses  | (22,550)                   | (24,717)      |
| <b>Operating income</b>   | <b>6,822</b>               | <b>5,874</b>  |
| Share of earnings of equity investments accounted for using the equity method   | (5)                        | (146)         |
| Financial expenses, net   | (1,456)                    | (1,870)       |
| <b>Income from continuing operations before taxes</b>   | <b>5,361</b>               | <b>3,858</b>  |
| Income taxes  | (2,462)                    | (1,896)       |
| <b>Net income before minority interests, discontinued operations/assets held for sale and cumulative effect of accounting changes</b> | <b>2,899</b>               | <b>1,962</b>  |
| Minority interests  | (1,167)                    | (479)         |
| Net income (loss) from discontinued operations/assets held for sale   | (191)                      | 409           |
| Cumulative effect of accounting changes, net of taxes   |                            | 47            |
| <b>Net income</b>   | <b>1,541</b>               | <b>1,939</b>  |
| <b>Basic and Diluted Earnings Per Share (EPS) (*) (**)</b>  | <b>(Euro)</b>              | <b>(Euro)</b> |
| <i>OrdinaryShare</i>  | 0.09                       | 0.10          |
| <i>SavingsShare</i>   | 0.10                       | 0.11          |
| <i>Of which:</i>  |                            |               |
| <i>From continuing operations</i>   |                            |               |
| <i>OrdinaryShare</i>  | 0.10                       | 0.08          |
| <i>SavingsShare</i>   | 0.11                       | 0.09          |
| <i>From discontinued operations/assets held for sale</i>  |                            |               |
| <i>OrdinaryShare</i>  | (0.01)                     | 0.02          |
| <i>SavingsShare</i>   | (0.01)                     | 0.02          |

(\*) Basic EPS is equal to Diluted EPS.

(\*\*) Change in accounting principle for Employee severance indemnities has no effect on Earnings Per Share.

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**NOTE 45 ADDITIONAL U.S. GAAP DISCLOSURES****(A) RECENTLY ISSUED U.S. GAAP ACCOUNTING STANDARDS**

In December, 2004, the FASB issued Statement 123 (revised 2004) ( SFAS 123(R) ), *Share-Based Payment* . SFAS 123(R) replaces FASB Statement No. 123, *Accounting for Stock-Based Compensation* , which superseded APB Opinion No. 25, *Accounting for Stock Issued to Employees* . SFAS 123(R) requires all share-based awards to employees, including grants of employee stock options, be recognized in the financial statements based on their grant-date fair values. The related compensation costs are to be recognized over the period during which an employee is required to provide service in exchange for the award. Excess tax benefits are to be recognized as an addition to paid-in capital and reflected as financing cash inflows in the statement of cash flows. We will adopt the prospective provisions of SFAS 123(R) to new and existing plans as of January 1, 2006. The grant-date fair values of unvested awards that are outstanding on the date of adoption will be charged to expense over their remaining vesting periods. We do not expect that the adoption of SFAS 123(R) will have a material impact on our consolidated financial position or results of operations.

In March, 2005, the Securities and Exchange Commission ( SEC ) issued Staff Accounting Bulletin ( SAB ) No. 107, *Share Based Payment* . SAB 107 summarizes the views of the SEC staff regarding the interaction between SFAS 123(R) and certain SEC rules and regulations, and provides the staff 's views regarding the valuation of share-based payment arrangements for public companies. We will adopt SAB 107 concurrently with the adoption of SFAS 123(R) with effect from January 1, 2006. Telecom Italia does not expect the adoption of this SAB to have a material impact on its consolidated financial position or results of operations.

In December 2004, the FASB issued Statement 153 ( SFAS 153 ), *Exchanges of Non-monetary Assets an amendment of APB Opinion No. 29* . The guidance in Accounting Principles Board Opinion 29 ( APB 29 ), *Accounting for Non-monetary Transactions* is based on the general principle that exchanges of non-monetary assets should be measured based on the fair value of the assets exchanged. The guidance in APB 29 included certain exceptions to that principle. SFAS 153 amends APB 29 to eliminate the narrow exception for non-monetary exchanges of similar productive assets and replaces it with a broader exception for exchanges of non-monetary assets that do not have commercial substance (that is, transactions where future cash flows are not expected to significantly change as a result of the exchange). Telecom Italia will adopt the provisions of SFAS 153 for non-monetary asset exchange transactions entered into after December 31, 2005. Telecom Italia does not expect the adoption of SFAS 153 to have a material impact on its consolidated financial position or results of operations.

In March 2005, the FASB issued FSP FIN 46R-5 ( FSP FIN 46R-5 ), *Implicit Variable Interests under FASB Interpretation No. 46 (FIN 46R-revised December 2003), Consolidation of Variable Interest Entities* .

FSP FIN 46R-5 requires a reporting enterprise to consider whether it holds an implicit variable interest in a variable interest entity (VIE) or potential VIE. We will adopt the provisions of FSP FIN 46R-5 in the reporting period beginning on January 1, 2006. Telecom Italia does not expect the adoption of FSP FIN 46R-5 to have a material impact on its consolidated financial position or results of operations.

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In May 2005, the FASB issued Statement of Financial Accounting Standards No. 154 ( SFAS 154 ), *Accounting Changes and Error Corrections* . Statement 154 replaces APB Opinion No. 20, *Accounting Changes* and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements* . SFAS 154 applies to all voluntary changes in accounting principles and changes the accounting for and reporting of a change in accounting principles, and requires the retrospective application to prior periods financial statements of a voluntary change in accounting principles unless it is impracticable. SFAS 154 is effective for accounting changes and correction of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS 154 will only have an effect when Telecom Italia implements changes in accounting principles that are addressed by the standard or corrects accounting errors in future periods.

In July 2005, the FASB issued FSP APB 18-1 ( FSP APB 18-1 ), *Accounting by an Investor for its Proportionate Share of Other Comprehensive Income of an Investee Accounted for under the Equity Method in Accordance with APB Opinion No. 18 upon a Loss of Significant Influence* . The FSP requires that if an investor loses significant influence over an investee, the investor s proportionate share of the investee s equity adjustments for Other Comprehensive Income should be offset against the carrying value of the investment at the time significant influence is lost by the investor. Telecom Italia will adopt the provisions of FSP APB 18-1 in the reporting period beginning on January 1, 2006. Telecom Italia does not expect the adoption of FSP APB 18-1 to have a material impact on its consolidated financial position or results of operations.

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In November 2005, the FASB issued FSP Nos. FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, which effectively nullifies the requirements of EITF Issue No. 03-1. This FSP provides guidance on determining when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. Telecom Italia will adopt the provisions of this FSP in the reporting period beginning January 1, 2006. Telecom Italia does not expect the adoption of this FSP to have a material impact on its consolidated financial position or results of operations.

In February 2006, the FASB issued FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments, an amendment of FASB Statements No. 133 and 140* (SFAS 155). SFAS 155 amends FASB Statements No. 133, *Accounting for Derivative Instruments and Hedging Activities* (SFAS 133), and No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. SFAS 155, among other things, permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. SFAS 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. Telecom Italia does not expect that the standard will have a material effect on its consolidated financial position, or results of operations as reconciled to U.S. GAAP.

Other recent accounting pronouncements issued by the FASB (including its Emerging Issues Task Force), the AICPA and the SEC did not or are not believed by management to have a material impact on Telecom Italia's present or future consolidated financial statements.

**(B) CHANGES IN ACCOUNTING PRINCIPLES**

Under IFRS, the Reserve for severance indemnities, to be accrued by Italian companies in accordance with the Italian Civil Code, is considered a defined benefit plan, and is based, among other things, on employees' years of service and remuneration earned by the employee during a pre-determined service period. The liability is determined by independent actuaries using the Projected Unit Credit Method.

Under U.S. GAAP, such benefits are considered a defined benefit plan or a defined contribution plan, and until December 31, 2004, the Group elected to account for it consistently with the Italian accounting policies as permitted by EITF 88-1 *Determination of Vested Benefit Obligation for a Defined Benefit Pension Plan*.

However, starting from 2005 under U.S. GAAP, the Reserve for severance indemnities is treated as a defined benefit plan, which is a permitted option under the EITF 88-1, and as a consequence no adjustment has been recorded in the shareholders' equity as of December 31, 2005.

The effect of the cumulative catch up adjustment of 47 million is separately disclosed in the condensed U.S. GAAP financial statements in accordance with APB 20 *Accounting Changes*. Had the change been applied in previous periods the net income for U.S. GAAP in 2004 would not have been significantly different.

**(C) SECURITIZATION OF ACCOUNTS RECEIVABLE**

As discussed in Note 3, the Group entered into certain transactions for the on-going sale of trade accounts receivable to a Qualified Special Purpose Entity in a securitization program.

In particular, Telecom Italia regularly sells a portfolio of trade receivables without recourse to the TI Securitization Vehicle S.r.l., a Special Purpose Entity (SPE) which finances the purchase of the receivables by issuing asset-backed securities. The sales price of the receivables is paid to Telecom Italia partly as an Advanced Purchase Price (APP), at the time of sale, and partly as a Deferred Purchase Price (DPP).

For invoices issued and sold through September 2005, with regard to the risk of uncollectability, Telecom Italia was responsible for the ultimate recovery from the debtors on the receivables sold, up to the limit of the amount of the DPP and the SPE retained the risk of uncollected amounts over the DPP. In accordance with SIC 12 (*Consolidation Special Purpose Entities* (SPE)) through September 30, 2005, TI Securitization Vehicle S.r.l. (TISV) was included in the scope of consolidation, because the exposure of the assignor to the risk of uncollectability of the deferred purchase price implied, in substance, control over the SPE.

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On December 15, 2005, the securitization program was restructured based on a Master DPP Transfer Agreement signed by Telecom Italia and certain financial institutions under which the DPP on Telecom Italia receivables relating to invoices issued between October 1, 2005 and May 31, 2006, are sold without recourse to such financial institutions.

Following the sale of the DPP without recourse, the risks and rewards of ownership of these receivables have been transferred in full to the financial institutions which take the control of SPE in accordance with SIC 12 provisions and, therefore, consolidate TISV.

For U.S. GAAP, the accounting for the securitization of accounts receivable is primarily governed by SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. Under the provisions of SFAS 140, the sale agreement must meet certain defined criteria to qualify as a sale of financial assets, the qualifying special purpose entity ( QSPE ) must meet certain defined criteria to preclude consolidation, and the amount of gain or loss on the sale is determined based on the consideration received, the carrying value of the underlying financial components sold and the fair value of the financial components retained. Even though the underlying accounting principles differ, there was no material difference on net equity and net income as of and for the years ended December 31, 2004 and 2005 between IFRS and U.S. GAAP.

Under the terms of the agreement, the Vehicle charges the Group an initial discount which varies based on the credit profile and other characteristics of each tranche of accounts receivable sold. Additionally, for the purposes of credit enhancement, the Vehicle withholds a portion of the purchase price as a deferred payment, representing the Group's retained interest in the sold receivables. The amount of deferred payment withheld is adjusted on a monthly basis based on an evaluation of actual collections, delinquencies and other factors. The Group retains the servicing responsibility related to the sold receivables and receives a servicing fee from the Vehicle which is estimated to approximate the fair value of providing such services. Due to the non-recourse sale of the DPP as described above, the remaining retained interest relates to receivables sold prior to October 2005.

During 2005 and 2004 the following cash flows were received from and paid to the Vehicle:

|  | Year ended<br>December 31, |            |
|--|----------------------------|------------|
|  | 2004                       | 2005       |
|  | (millions of Euro)         |            |
| Gross trade receivables sold to the Vehicle          | 8,821                      | 8,926      |
| Collections remitted to the Vehicle                  | (8,012)                    | (8,097)    |
| Discount   | (93)                       | (92)       |
| Remaining retained interest                          | (285)                      | (181)      |
| <b>Net cash received in advance from the Vehicle</b> | <b>431</b>                 | <b>556</b> |

The amounts recorded in the consolidated condensed balance sheets and statements of operations under U.S. GAAP for 2005 and 2004 are as follows:

|  | <u>2004</u>        | <u>2005</u> |
|--|--------------------|-------------|
|  | (millions of Euro) |             |
| Amounts due from the Vehicle                   | 869                | 829         |
| Retained interest                              | 285                | 181         |
| Allowance for bad debts                        | 23                 | 106         |
| Loss recognized in the statement of operations | 116                | 116         |

The losses on the sales of receivables to the Vehicle are due to the discount charged by the Vehicle and the bad debt provisions to adjust the retained risks to fair value as required by SFAS 140. The retained interests represent the deferred purchase price that has yet to be received from the Vehicle and are included under other current assets.

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During 2005, the Group sold over 800 real estate properties comprising both land and buildings to certain real estate funds. Counterparties to the transaction include Pirelli Real Estate S.p.A. which is a related party as disclosed in Note 39 Other Information. Neither Telecom Italia, its subsidiaries nor any related parties have provided any form of guarantee to any of the investors or debt holders with respect to their investment in the real estate assets acquired.

SFAS 13 *Accounting for leases* ( SFAS 13 ) requires that in a sale-leaseback transaction with a lease classified as an operating lease, any profit or loss on the sale shall be deferred and amortized in proportion to the rental payments over the period of time that the asset is expected to be used. Under IAS 17 *Leases*, the profit corresponding to the disposal of the asset is not deferred if the transaction was made with a selling price and rental payments correspond to the market conditions at the time of the transaction.

IAS 17 *Leases* and SFAS 13 prescribe similar lease accounting approaches based on whether a lease transfers substantially all of the risks and rewards related to ownership of the leased asset. However, SFAS 13 provide quantitative criteria to determine if a lease is an operating lease or a capital lease where IAS 17 requires subjective determinations to be made. It could lead in certain rare circumstances to consider a lease as operating lease under U.S. GAAP and as finance lease under IAS 17 and vice versa.

**(E) GOODWILL AND OTHER INTANGIBLE ASSETS**

The roll-forward schedule of goodwill by Business Unit, under U.S. GAAP from January 1, 2004 to December 31, 2005, is as follows:

|  | Wireline           | Mobile        | Media      | Olivetti | Other activities | CONSOLIDATED  |
|--|--------------------|---------------|------------|----------|------------------|---------------|
|  | (millions of Euro) |               |            |          |                  |               |
| <b>Goodwill as of January 1, 2004</b>      | <b>24,484</b>      | <b>12,948</b> | <b>212</b> | <b>7</b> | <b>176</b>       | <b>37,827</b> |
| Acquisitions and disposals, net            | 3                  | 219           | 232        |          | (22)             | 432           |
| Transfer to discontinued operations        | (55)               | (529)         | (20)       |          | (164)            | (768)         |
| Other                                      | (3)                | (24)          |            |          | 10               | (17)          |
| <b>Goodwill as of December 31, 2004</b>    | <b>24,429</b>      | <b>12,614</b> | <b>424</b> | <b>7</b> |                  | <b>37,474</b> |
| Acquisitions and disposals, net            | 251                | 12,057        | 134        | (7)      |                  | 12,435        |
| Reclassification from Internet to Wireline | 413                |               | (413)      |          |                  |               |
| Other                                      | 248                |               |            |          |                  | 248           |
| <b>Goodwill as of December 31, 2005</b>    | <b>25,341</b>      | <b>24,671</b> | <b>145</b> |          |                  | <b>50,157</b> |

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During 2005, the Group underwent a reorganization and transferred the Internet Business from Telecom Italia Media to Telecom Italia. As a result, the Group has reallocated the goodwill attributable to the Internet business into Wireline based on the relative fair value of the Internet activities to the total fair value of the Internet and Media businesses.

As a result of purchase accounting in 2005 and previous years, the Group has recorded the following intangible assets with indefinite useful lives:

|                    | <u>2004</u>         | <u>2005</u>         |
|--------------------|---------------------|---------------------|
|                    | (millions of Euro)  |                     |
| Wireline brandname | 1,283               | 1,283               |
| Mobile brandname   | 954                 | 1,671               |
| Other              | 25                  | 57                  |
| <b>Total</b>       | <b><u>2,262</u></b> | <b><u>3,011</u></b> |

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Amortization expense for the years ended December 31, 2004 and 2005 was 2,618 million and 3,076 million, respectively. The following table presents expected amortization of intangible assets for each of the next five fiscal years based on the carrying values as of December 31, 2005:

|      | <u>(millions of Euro)</u> |
|------|---------------------------|
| 2006 | 3,302                     |
| 2007 | 3,295                     |
| 2008 | 2,225                     |
| 2009 | 1,736                     |
| 2010 | 1,730                     |

**(F) STOCK-BASED COMPENSATION**

The Group accounts for all stock-based compensation under the provisions and related interpretations of Accounting Principles Board Opinion ( APB ) No. 25, *Accounting for Stock Issued to Employees* . Certain companies within the Group that have publicly traded stock also issue options to their employees.

SFAS 123, *Accounting for Stock-Based Compensation* requires the disclosure of pro forma net income per share as if the Group had adopted fair-value accounting for stock-based awards.

The Group uses the Cox-Ross-Rubenstein ( CRR ) binomial model for estimating the fair value of employee stock options. The CRR model uses a binomial tree to assess the probabilities that the price of the underlying stock might follow over the life of the option. The CRR model takes into account possible future stock prices at specified times between the grant date and the option maturity. The CRR model also has the flexibility to incorporate assumptions related to the payment level of future dividends. The CRR model was designed for these types of options, therefore it provides more useful fair value information.

The following weighted average assumptions were used in the estimated grant date fair value calculations for all stock option awards.

The Group's pro forma earnings had compensation costs been recorded in accordance with SFAS 123 are presented below for all plans:

|  | <u>2004</u>  | <u>2005</u>  |
|--|--------------|--------------|
| <b>Net income in accordance with U.S. GAAP</b>     | <b>1,541</b> | <b>1,939</b> |
| Add: Stock-based compensation expense under APB 25 | 3            | 2            |

|   |              |              |
|---|--------------|--------------|
| Less: Total stock-based compensation expense under SFAS 123 | (25)         | (5)          |
| <b>Pro forma net income</b>                                 | <b>1,519</b> | <b>1,936</b> |

The Group's pro forma earnings per share, had compensation costs been recorded in accordance with SFAS 123, would not be materially affected.

The details of all outstanding plans are provided in Note 39 Other Information .

## (G) SUBSEQUENT EVENTS

### *Second tranche of properties sold to the Raissa fund*

As a part of the programme of real estate disposals for a total value of over 1 billion, approved by the Board of Directors on December 21, 2005, on March 29, 2006, the Group concluded the sale and leaseback of a second tranche of 210 properties to the closed-end fund denominated Raissa.

The value of the transaction is approximately 158 million, with a gross capital gain of approximately 57 million.

The transaction will have a positive impact on the consolidated financial debt of the Telecom Italia Group of approximately 125 million, before taxes.

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During March 2006, the merger of Blah! and CRC Centro de Relacionamento com Clientes, into TIM Celular was executed and the project to contribute all the TIM Celular shares held by TIM Brasil to TIM Participações was approved by the TIM Participações extraordinary shareholders meeting. Both of these transactions are part of the process to streamline the corporate structure of the companies of the Telecom Italia Group which make up the mobile sector. This process will encompass all the companies that are currently 100 percent-controlled, directly or indirectly, by TIM Participações (namely, TIM Sul S.A., TIM Nordeste Telecomunicações S.A., TIM Celular S.A. and Maxitel S.A.), with the aim of (i) further uniting and rationalizing the operations of the activities relating to the mobile business, (ii) significantly reducing the costs associated with maintaining distinct and separate companies, (iii) developing synergies among the various companies and (iv) improving tax and financial efficiency.

***Brazil***

On March 15, 2006, Brasil Telecom Celular and Brasil Telecom filed a request for arbitration against TIM International and TIM Brasil before the International Chamber of Commerce, with seat in Brasília, pursuant to the Merger Agreement entered into by such parties on April 28, 2005, requesting the Arbitration Tribunal to declare the Merger Agreement null and void ab initio or, alternatively, be declared void at Brasil Telecom's insistence. Furthermore, Brasil Telecom is seeking damages, to be determined by the Arbitration Tribunal, for all losses it has allegedly suffered. The parties have already nominated their respective arbitrators.

***Change of Rating Triggers***

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.

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,<br>2006 | Latest update December<br>7,<br>2004 | Latest update April 11,<br>2006 |

Rating  
BBB+

Outlook  
Negative

Rating  
Baa2

Outlook  
Stable

Rating  
BBB+

Outlook  
Stable

***Approval of a 1 Billion Share Buy Back by the Shareholders Meeting***

On April 13, 2006, the Shareholders Meeting authorized the repurchase of Ordinary and Savings Shares of Telecom Italia, in accordance with the Italian legal limits and with a total maximum purchase price of 1 billion for a period of 18 months. The meeting also gave the Board of Directors the power to sell the repurchased shares over the same period. The repurchased shares will be treated as treasury stock which are not currently expected to be cancelled.

***Repayment of Notes Telecom Italia Finance S.A.***

On April 20, 2006, the bond issued by Telecom Italia Finance S.A., with an annual coupon of 6.375% (originally 6.125%, 6.375% consequently to the step-up of the coupon) became due and was repaid in the amount of 2.5 billion.

***Sale of Neuf Télécom***

On May 9, 2006 Telecom Italia, through its subsidiary Telecom Italia International N.V., sold its 4.99% stake in Neuf Télécom to the Louis Dreyfus ( **LD** ) and Societè Francaise du Radiotéléphone ( **SFR** ) groups for

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approximately 161 million, as well as an additional payment in the case of an Initial Public Offering, or sale of control of Neuf Télécom, at values higher than those agreed. Should neither of these events take place before December 31, 2007, Telecom Italia International N.V. will still have rights to an additional payment if the fair market value of the stake at that date is higher than the price of the present transaction. The closing took place on May 11, 2006.

The sale gave the Telecom Italia Group a capital gain of 110 million and a positive impact on net financial debt of 161 million.

The sale of the Neuf Télécom stake is part of the Telecom Italia Group's strategy of rationalizing its international portfolio with a focus on areas of strategic interest and potential for growth.

***New Bond Issue (in Pound Sterling and Euro) for a total of 1.3 billion***

On May 11, 2005, Telecom Italia S.p.A. priced a benchmark fixed-rate bond issue, in Euro and Pound Sterling, aimed at institutional investors, with respective maturities of 8 and 17 years, for a total amount of approximately 1.3 billion.

The terms are as follows:

- **Pound Sterling Tranche:** issue date May 19, 2006, nominal amount of GBP 400 million with an annual fixed rate coupon of 5.875%, issue price 99.622%, maturity May 19, 2023;
- **Euro Tranche:** issue date May 19, 2006, nominal amount of 750 million with an annual fixed rate coupon of 4.75%, issue price 99.156%, maturity May 19, 2014.

The bonds were issued pursuant to Telecom Italia's 15 billion Euro Medium Term Note (EMTN) Program. The joint bookrunners for the transaction were BNP Paribas, Calyon, Deutsche Bank and HSBC.

Application for the listing of the notes shall be made with the Luxembourg stock exchange.