

TELECOM ITALIA S P A  
Form 20-F/A  
September 02, 2004  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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**FORM 20-F/A**

**.. 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, 2003

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

Commission file number: 1-13882

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**Telecom Italia S.p.A.**

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(Exact name of Registrant as specified in its charter)

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Italy

(Jurisdiction of incorporation or organization)

Piazza degli Affari 2, 20123 Milan, Italy

(Address of principal executive offices)

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**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 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.

**Not applicable**

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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  Not Applicable

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

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

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**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 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 the Italian law governing consolidated financial statements interpreted and integrated by the accounting principles established or adopted by the Italian Accounting Profession ( Italian GAAP ), which, as described in Note 27 of 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 herein.

**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 targets under our 2004-2006 business plan and 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 Risk Factors, (ii) Item 4. Information on the Telecom Italia Group Business Significant Developments during 2003 Updated Business Plan and Strategy, (iii) Item 4. Information on the Telecom Italia Group Regulation, (iv) Item 5. Operating and Financial Review and Prospects, (v) Item 8. Financial Information Legal Proceedings and (vi) Item 11. Quantitative and Qualitative Disclosures About Market Risk, 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:

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

- the success of our customer loyalty and retention programs, particularly in the fixed line business, 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;
- the impact and consequences of the Merger;
- the impact of the slowdown in Latin American economies and the slow recovery of economies generally on our international business focused on Latin America and on our foreign investments and capital expenditures;
- the continuing impact of rapid or disruptive changes in technologies;

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- 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 2004-2006 Industrial Plan;
- our ability to successfully achieve our debt reduction targets;
- our ability to successfully roll out our UMTS networks and services and to realize the benefits of our investment in UMTS licenses and related capital expenditures;
- our ability to successfully implement our internet and broadband strategy both in Italy and abroad;
- our ability to achieve the expected return on the significant investments and capital expenditures we have made and continue to make in Latin America;
- 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 Risk Factors and the related cautionary statement under Item 5. Operating and Financial Review and Prospects .

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**KEY DEFINITIONS**

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

<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>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>Merger</b>	means the merger of Old Telecom Italia into Olivetti, approved by the shareholders of Old Telecom Italia and Olivetti on May 24, 2003 and on May 26, 2003, respectively, which became effective on August 4, 2003.
<b>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>TIM</b>	means Telecom Italia Mobile S.p.A., the Telecom Italia Group's subsidiary operating in the mobile telecommunications business.
<b>Telecom Italia Media</b>	means the corporate name of the remaining part of Seat Pagine Gialle S.p.A., which resulted after the proportional spin-off of the directories and almost all 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 the Internet & Media business.
<b>EU</b>	means the European Union.

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**PART I**

**Item 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

**Not Applicable**

**Item 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

**Not Applicable**

**Item 3. KEY INFORMATION**

**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, our fixed-line and mobile voice telecommunications businesses. This competition may increase further due to the consolidation and globalization of the telecommunications industry in Europe and elsewhere. Consolidation is increasing rapidly and competition is expected to rise at all levels in the future. In addition, the use of the single European currency and the liberalization of the Italian telecommunication market has further 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, 2003, there were a number of significant competitors offering fixed-line services and three other operators offering mobile services in the Italian domestic market; the third mobile competitor (H3G) entered the market in 2003, offering third generation commercial services. Although we stopped the decline in our market share of voice traffic in our fixed line business during 2003, continuing pressures on prices due to competition and further erosion in market shares could adversely affect our results of operations. Additional changes in the regulatory regime, including carrier preselection, number portability and local loop unbundling as well as the implementation of new EU telecommunications directives could further increase competition for the services we provide, particularly in our fixed line business, which could also adversely affect our business.

*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 services to increase traffic on our networks and find alternative

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revenue sources, in addition to carrying voice traffic on our networks. These services include non-voice services such as ADSL, which provides services such as fast Internet, multimedia and video conferencing, data traffic and value-added services such as interactive mobile services that allow users to receive news or engage in simple banking transactions. Other revenue sources also include increased interconnection traffic from other operators using our fixed-line network. In addition to the introduction of new services in recent years, we continue to develop new products and services, such as new data services for business customers, broadband services, enhanced communication services and new equipment and voice packages, in order to attract and retain customers, particularly business customers, and to stimulate usage of our fixed and wireless telecommunications network. We are also investing in new infrastructure and technologies to enable us to introduce new products and services. We expect that these strategic initiatives will 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 business plans, particularly in light of the Merger. Factors beyond our control may prevent us from successfully implementing our strategy.***

Following the change in control of Old Telecom Italia in late 2001, we adopted our 2002-2004 Industrial Plan (the Industrial Plan ) and established priorities for this three year period. The main objectives were to:

- Strengthen competitive capabilities;

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- Improve cost efficiency; and
- Strengthen the financial structure.

Significant portions of the Industrial Plan were completed during 2002 and 2003, particularly the sale of non-core assets and debt reduction. We also took steps to strengthen our competitive position in our core Italian domestic market through the introduction of new products and tariff packages and our focus on lowering costs through the reduction of operating expenses and capital expenditures.

In connection with the Merger, we confirmed the objectives and guidelines of the Industrial Plan and stated that we had established certain targets, which include strict limits on capital expenditures and cost controls, together with further assets sales, to reduce the significantly higher levels of debt we have as a result of the Merger.

Factors beyond our control that could affect the further implementation and completion of the Industrial Plan and reaching our targets for the period 2004-2006 include:

- our ability to manage costs;
- our ability to attract and retain highly-skilled and qualified personnel;
- our ability to divest additional non-core businesses and the adequacy of the returns of such divestitures;
- our ability to leverage on our core skills with particular focus on Latin America mobile and international broadband operations;
- difficulties in developing and introducing new technologies, managing innovation, providing value-added services and increasing usage of our networks;
- our ability to manage the fixed to mobile substitution trends;
- 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;
- the effect of foreign exchange fluctuations on our results of operations; and
- the success of new disruptive technologies that could cannibalize fixed and mobile revenues.

*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 significant extensive regulatory requirements in Italy and our international operations and investments are subject to regulation in their host countries. In Italy, we are the only operator subject to universal service obligations, which requires us to provide:

- fixed line public voice telecommunications services in non-profitable areas;
- subscriber information services at affordable prices; and
- public payphones.

In addition, the Italian regulator responsible in Italy for the regulation of the telecommunications, radio and television broadcasting sector (the National Regulatory Authority ) has identified the Company as an operator having significant market power in all relevant markets. As a result, we are, or 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-oriented 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 directly to access customers connected to the network by leasing the necessary components from us.



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As a member of the EU, Italy is required to adapt 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. The implementation of these revised telecommunications regulations and possible future decisions relating thereto may change the regulatory environment in a manner adverse to us. Please see Item 4. Information on the Telecom Italia Group Regulation in this report for more information on the regulatory requirements to which we are subject.

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. In addition, changes in tax laws in countries in which we operate could adversely affect our results of operations. 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.

*We may not achieve the expected return on our significant investments and capital expenditures made in Latin America due to the competitive environment 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;
- developing our international investments in high-growth market segments, such as wireless, data and internet (broadband);
- strengthening our role of 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 participations in non-strategic geographical markets.

As a result of this change in strategy, in the 2002-2003 period we divested certain of our most significant European assets such as BDT (Bouygues Decaux Telecom), Autel (Mobikom Austria), Telekom Austria, 9Telecom group and Auna and we are still seeking to divest certain international non-strategic assets. In addition, certain investments which were made during the 1999-2001 period declined significantly in value resulting in write-downs and asset impairments which materially adversely affected our results of operations in 2001 and 2002, with a lesser impact in 2003. 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 require significant capital expenditures and there can be no assurance that we will be able to achieve a return on our investments in markets where we have previously suffered losses and writedowns.

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

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Many of the services we offer are technology-intensive and the development of new technologies may render such services non-competitive. 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. 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

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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. We have had investments in Turkey, Argentina and Brazil in recent years in which we have had to take significant write-downs in value due to political and economic developments in those countries. 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.

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

Because we have made substantial international investments, primarily in U.S. dollars, and have significantly expanded our operations outside the euro zone, particularly in Latin America, movements in the exchange rates of the euro against other currencies can adversely affect our revenues and operating 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 raised, and may raise in an increasing proportion in the future, financing in currencies other than the euro, principally the U.S. dollar. Accordingly, the value of those liabilities will be affected by fluctuations of the currencies of the countries in which we operate against the currency in which the financing is denominated. We generally enter into a number of forward currency transactions, swaps and options to manage foreign currency risk exposure with respect to our non-euro denominated liabilities. However, we can give no assurances that we will be successful in managing foreign currency risk exposure, taking into consideration that appropriate foreign currency swaps and options may not be available as needed on the relevant financial markets. In recent years reported results of our Latin American operations have been adversely affected by changes in local currencies against the euro. During 2003, in particular, the strengthening of the euro against local currencies in Latin America adversely affected our reported revenues in euro by 641 million.

Our total gross financial debt at year end 2003 was 41,465 million ( 40,631 million at year end 2002) and included borrowings of 5,274 million relating to the cash out for the Merger. Although our total interest payable has decreased as the result of average debt exposure reduction and of interest rate fluctuations our exposure of total debt subject to floating interest rates increased as a result of the Merger. 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, we can give no assurance that fluctuations in interest rates will not adversely affect our results of operations.

### ***We may not realize the benefits of our investment in UMTS licenses and related capital expenditures.***

Through our mobile businesses, we have acquired two third generation mobile telephone, or UMTS, licenses to commence operations of UMTS services in Italy and Greece. Our Italian mobile company, TIM, committed to pay 2,417 million for its license, with 2,066 million paid in December 2000 and three installments of 117 million paid in November 2001, November 2002 and December 2003, for its UMTS license in Italy and, through its subsidiary STET Hellas, a further 145 million for a UMTS license in Greece (of which approximately 101 million has already been paid). The size of the market for UMTS products and services is unknown and may fall short of the industry's expectations. We cannot be certain that the demand for such services will justify the related costs. In some locations, we have made investments, although required under the licenses, which may not be commercially desirable. In addition, we have a number of significant competitors in each of these geographic markets planning to offer these services.

We will be rolling out the UMTS networks, together with our competitors, in compliance with the terms and conditions of our respective licenses. Given the substantial costs of upgrading our existing networks to support UMTS and the uncertainty regarding the commercial adoption of UMTS, we may not be able to recoup our investment according to our estimates, if at all. The commercial success of UMTS will also depend on handset availability and their price. We have entered into and intend to enter into arrangements with other operators to share the costs and infrastructure of our planned UMTS networks. However, we cannot give any assurance that we will succeed in concluding the

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necessary agreements with other operators on satisfactory terms. Moreover, while network sharing is intended to reduce costs, we cannot give any assurance that this will be the case or that we will be able to make such network sharing work commercially or technically.

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*The mobile telecommunications market in Italy has matured and become saturated in recent years and growth has slowed significantly which means our revenues may not grow as rapidly as in the past.*

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 flat or declining revenues in our Italian fixed line business. This growth has been driven largely by the rapid expansion of the mobile telecommunications market in Italy. However, as a result of this growth, the Italian market is approaching saturation levels, with penetration rates now around 99%. TIM's domestic market share has remained relatively stable at approximately 46% in the past two years so revenue growth is no longer driven by the rapid subscriber growth which TIM experienced in the 1998-2001 period.

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, including consolidation, tariff reductions and handset subsidies;
- the development and introduction of new and alternative technologies for mobile telecommunications products and services and the attractiveness of these to customers;
- the success of new disruptive technologies;
- customer usage habits;
- general economic conditions; and
- health risks or safety concerns associated with mobile telephones and transmission equipment.

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.

*Devaluations of telecom assets and write-downs could adversely affect our financial condition and results of operations.*

In the past three years the market for telecom stocks and credit ratings of market participants, as well as our ongoing review and refinement of our business plan, has resulted in substantial impairment write-downs of our assets which materially adversely affected our results of operations in 2001 and 2002. There can be no assurance that similar events in the future may not result in further substantial impairment write-downs from assets. Accounting standards relating to asset valuations and impairment may be refined to require the use of new criteria or methodology. Beginning in fiscal year 2002, under U.S. GAAP, we tested goodwill for impairment pursuant to SFAS 142 Goodwill and Other Intangible Assets. In accordance with the provisions of SFAS 142, goodwill is no longer amortized, but is subject to annual impairment tests based on fair value. An interim assessment of goodwill may be necessary if an impairment indicator indicates that the fair value of a reporting unit may have decreased. Future changes in the fair value of our business units could adversely affect our U.S. GAAP results and financial conditions.

*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 are 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 contents 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 that we can offer; and
- we experience any network interruptions or related problems with network infrastructure.

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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 our business and results of operations.

*System failures could result in reduced user traffic and reduced revenue and could harm our 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.

*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.

*As a result of the Merger of Old Telecom Italia and Olivetti we remain highly leveraged.*

Under Italian GAAP, our gross financial debt was 41,465 million at December 31, 2003, compared with 40,631 million at December 31, 2002, and our total net financial debt was approximately 33,346 million as of December 31, 2003 compared with 33,399 million at December 31, 2002. See Note 9 of Selected Financial and Statistical Information which reconciles our net financial debt to our gross debt. The amounts at December 31, 2003 take into account the Merger, including indebtedness of 5.3 billion incurred to finance the withdrawal rights and the tender offers which were part of the overall Merger transaction. We were able to maintain our overall gross and net financial debt levels after giving effect to the 5.3 billion described above due to:

- significant cash flow generation by our core businesses as well as by our focus on the management of working capital, and

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- net proceeds from disposals completed during 2003 used to reduce outstanding debt which offset the borrowings needed for the cash out for the Merger.

By the end of 2004, we are targeting to reduce our net financial debt below 30 billion principally through cash flow generation. There can be no assurance that factors beyond our control, including but not limited to deterioration in general economic conditions, will not significantly affect our ability to reduce such debt.

***In 2005 we will be obliged to adopt International Financial Reporting Standards ( IFRS ) which will impact our financial results as they differ in significant respects from Italian GAAP.***

We currently prepare our financial statements in accordance with Italian GAAP. In June 2002, the Council of Ministers of the EU adopted new regulations requiring all listed EU companies, including us, to apply IFRS (previously known as International Accounting Standards or IAS ) in preparing their consolidated financial statements from January 1, 2005. Because IFRS emphasizes the measure of the fair value of certain assets and liabilities, applying these standards to our financial statements may have a considerable impact on a number of important areas, including, among others, goodwill and intangible assets, employee benefits and financial instruments, accounting for share-based payments, long-term assets and business combinations. Because our financial statements prepared in accordance with IFRS will differ from our financial statements prepared in accordance with Italian GAAP, the methods used by the financial community to assess our financial performance and value our publicly-traded securities could be affected. Please see Item 5. Operating and Financial Review and Prospects Adoption of International Accounting Standards .



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### ***Risks associated with Telecom Italia's ownership chain***

Although, as a result of the Merger, no shareholder controls Telecom Italia, because of the voto di lista system for the election of directors, currently 15 out of 19 of our directors (of whom, however, 10 are considered independent) were elected from a slate of candidates proposed by Olimpia, which is currently the largest shareholder in Telecom Italia with a stake of approximately 17%. See Item 7. Major Shareholders and Related-Party Transactions Major Shareholders The Olimpia Shareholders Agreements .

In addition, Marco Tronchetti Provera and Carlo Orazio Buora, respectively Executive Chairman and Managing Director of Telecom Italia, are also, respectively, Chairman and Managing Director of Pirelli & C. S.p.A., which currently owns a 50.4% stake in Olimpia. Mr. Tronchetti Provera is Chairman of Olimpia and Mr. Buora is a member of Olimpia's board of directors. See Item 6. Directors, Senior Management and Employees Directors Biographical Data .

Although Olimpia does not own a controlling interest in Telecom Italia voting shares, Olimpia retains significant power as a result of its proposal of a majority of the present Telecom Italia Board members who were elected in May 2004. As a result, Olimpia, may be able to influence certain corporate actions and may exert a significant influence on all matters to be decided by a vote of shareholders. In principle, the interests of Olimpia in deciding these 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 approve or disapprove of 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 a recent decree and the special powers themselves are undergoing further changes, 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. See Item 7. Major Shareholders and Related-Party Transactions Major Shareholders Continuing Relationship with the Treasury .

**Table of Contents****EXCHANGE RATES**

We published 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 European Union on January 1, 1999. References to **₺**, **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. The exchange rate at which the lira was irrevocably fixed against the euro is  $\text{Lit.}1,936.27 = 1.00$ .

For convenience only (except where noted otherwise), certain euro figures have been translated into dollars at the rate (the **Euro/Dollar Exchange Rate**) of  $1.00 = \text{U.S.}\$1.2210$ , 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 June 1, 2004. 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 1999 to 2003 and for the beginning of 2004 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>
1999	1.1812	1.0016	1.0588	1.0070
2000	1.0335	0.8270	0.9207	0.9388
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 (through June 1, 2004)	1.2853	1.1801	1.2265	1.2210
<b>Monthly Amounts</b>				
December 2003	1.2597	1.1956	1.2284	1.2597
January 2004	1.2853	1.2389	1.2638	1.2452
February 2004	1.2848	1.2426	1.2640	1.2441
March 2004	1.2431	1.2088	1.2261	1.2292
April 2004	1.2358	1.1802	1.1989	1.1975
May 2004	1.2274	1.1801	1.1989	1.1975
June 2004 (through June 1, 2004)	1.2210	1.2210	1.2210	1.2210

(1) Average of the rates for the last business day of each month in the relevant period except for 2004 for which the date used is June 1, 2004.

The shares and savings shares of Old Telecom Italia and the 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.

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dollar will affect the U.S. dollar equivalent of the euro price of the Shares and the Savings Shares and the price of the American Depositary Shares ( 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 ADSs and Savings Share ADSs upon conversion by the Depositary of cash dividends paid in euro on the underlying Shares and Savings Shares. See Item 10. Additional Information 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 Shares and Savings Shares issued at completion of the Merger, on the NYSE where such Shares and Savings Shares trade in the form of ADSs.

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**SELECTED FINANCIAL AND STATISTICAL INFORMATION**

The Merger of Old Telecom Italia with and into Olivetti became effective on August 4, 2003. Olivetti was the surviving company in the Merger (and changed its name to Telecom Italia S.p.A.), and succeeded to the business of Old Telecom Italia.

As a result of the Merger, the summary selected financial data set forth below are consolidated financial data of Olivetti, not Old Telecom Italia, and are presented on the following basis:

- the Telecom Italia Group's selected financial data as of and for the year ended December 31, 2003 have been extracted or derived from the consolidated financial statements of the Telecom Italia Group prepared in accordance with Italian GAAP and which have been audited by Reconta Ernst & Young S.p.A. independent auditor;
- the Telecom Italia Group's selected financial data as of and for each of the years ended December 31, 2002, 2001, 2000 and 1999 have been extracted or derived (other than the 2000 pro forma data) from the Olivetti Group's consolidated financial statements prepared in accordance with Italian GAAP and which have been audited by the following independent auditors: Reconta Ernst & Young S.p.A. (for the years ended December 31, 2002 and 2001), PricewaterhouseCoopers S.p.A. (for the years ended December 31, 2000 and 1999); and
- the summary historical consolidated financial data for the Telecom Italia Group as of March 31, 2004, and for the three months ended March 31, 2004 and 2003, have been derived from unaudited interim consolidated financial statements which, in our opinion, reflect all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of our results of operations for the unaudited interim periods. Results for the three months ended March 31, 2004 are not necessarily indicative of results that may be expected for the entire year.

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Unless otherwise indicated, amounts presented are based on Italian GAAP. The selected financial data below should be read in conjunction with the Consolidated Financial Statements and notes thereto included elsewhere in this Annual Report.

	Year ended December 31,						Three Months	
							ended	
							March 31,	
	2000							
		pro forma (Unaudited) (1)(2)						
1999(1)	2000(1)		2001(1)	2002(1)	2003(1)	2003(1)	2004(1)	
(millions of Euro, except per share amounts)						(Unaudited)		
<b>Statement of Operations Data in accordance with Italian GAAP:</b>								
Operating revenues	28,207	30,116	28,374	32,016	31,408	30,850	7,291	7,418
Other income	512	483	459	476	504	345	69	58
<b>Total revenues</b>	<b>28,719</b>	<b>30,599</b>	<b>28,833</b>	<b>32,492</b>	<b>31,912</b>	<b>31,195</b>	<b>7,360</b>	<b>7,476</b>
Cost of materials	3,689	3,058	2,931	2,640	2,315	2,081	415	452
Salaries and social security contributions	5,231	5,245	4,965	4,919	4,737	4,303	1,115	1,033
Depreciation and amortization(3)	6,013	6,946	6,509	7,612	7,227	6,779	1,653	1,590
Other external charges	9,612	11,136	10,476	12,687	12,188	11,934	2,813	2,813
Changes in inventories	(79)	(318)	(296)	92	62	114	(18)	(44)
Capitalized internal construction costs	(1,066)	(912)	(831)	(583)	(675)	(805)	(145)	(156)
<b>Total operating expenses(3)</b>	<b>23,400</b>	<b>25,155</b>	<b>23,754</b>	<b>27,367</b>	<b>25,854</b>	<b>24,406</b>	<b>5,833</b>	<b>5,688</b>
<b>Operating income(3)</b>	<b>5,319</b>	<b>5,444</b>	<b>5,079</b>	<b>5,125</b>	<b>6,058</b>	<b>6,789</b>	<b>1,527</b>	<b>1,788</b>
Financial income	1,468	1,202	1,162	1,446	1,569	992	288	292
Financial expense(3)	(2,252)	(3,857)	(3,648)	(6,559)	(4,647)	(3,256)	(940)	(722)
<i>Of which write-downs and equity in losses in affiliated and other companies, net</i>	<i>(569)</i>	<i>(1,037)</i>	<i>(1,025)</i>	<i>(1,771)</i>	<i>(487)</i>	<i>(91)</i>	<i>(82)</i>	<i>(14)</i>
Other income and (expense), net	5,667	135	165	(3,109)	(5,496)	(1,083)	(7)	(14)
<b>Income (loss) before income taxes and minority interests</b>	<b>10,202</b>	<b>2,924</b>	<b>2,758</b>	<b>(3,097)</b>	<b>(2,516)</b>	<b>3,442</b>	<b>868</b>	<b>1,344</b>
Income taxes	(3,207)	(1,923)	(1,813)	(579)	2,210	(1,014)	(713)	(809)
<b>Net income (loss) before minority interests</b>	<b>6,995</b>	<b>1,001</b>	<b>945</b>	<b>(3,676)</b>	<b>(306)</b>	<b>2,428</b>	<b>155</b>	<b>535</b>
Minority interests	(2,056)	(1,941)	(1,885)	586	(467)	(1,236)	(552)	(258)
<b>Net income (loss)</b>	<b>4,939</b>	<b>(940)</b>	<b>(940)</b>	<b>(3,090)</b>	<b>(773)</b>	<b>1,192</b>	<b>(397)</b>	<b>277</b>

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Net income (loss) per Share(4)	1.03	(0.20)	(0.20)	(0.36)	(0.09)	0.07	(0.05)	0.01
Dividends per Share	0.0310	0.0350	0.0350			0.1041(5)		
Dividends per Savings Share	0.1937					0.1151(5)		
Dividends per Preferred Shares	0.0362							

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	Year ended December 31,					
	2000					
	pro forma					
	(Unaudited)					
	1999(1)	2000(1)	(1)(2)	2001(1)	2002(1)	2003(1)
	(millions of Euro, except per share amounts)					
<b>Amounts in accordance with U.S. GAAP:</b>						
Total revenues				30,849	30,432	30,519
Operating income				3,661	7,225	8,095
Net income (loss) before minority interests, discontinued operations and cumulative effect of accounting changes				(2,932)	6,231	3,135
Minority interests				18	(3,016)	(1,523)
Net income (loss) from discontinued operations				(1,112)	(1,259)	250
Cumulative effect of accounting changes, net of tax				20		(21)
Net income (loss)				(4,006)	1,956	1,841
Net income (loss) per Share before discontinued operations and cumulative effect of accounting changes Basic				(0.85)	0.79	0.18
Net income (loss) per Share before discontinued operations and cumulative effect of accounting changes Diluted				(0.85)	0.79	0.18
Net income (loss) per Share from discontinued operations Basic				0.01	0.00	0.00
Net income (loss) per Share from discontinued operations Diluted				0.01	0.00	0.00
Net income (loss) per Share from cumulative effect of accounting changes Basic				0.01	0.00	(0.00)
Net income (loss) per Share from cumulative effect of accounting changes Diluted				0.01	0.00	(0.00)
Net income (loss) per Share Basic(6)				(1.17)	0.48	0.20
Net income (loss) per Share Diluted(6)				(1.17)	0.48	0.20

	As of December 31,						As of March 31,
	2000						
	pro forma						
	(Unaudited)						
	1999(1)	2000(1)	(1)(2)	2001(1)	2002(1)	2003(1)	2004(1)
	(millions of Euro)						(Unaudited)
<b>Balance Sheet Data in accordance with Italian GAAP:</b>							
Total current assets(3)	15,892	21,097	20,957	23,417	22,597	22,498	22,082
Fixed assets, net	23,865	23,776	21,072	22,097	19,449	18,324	17,977
Intangible assets, net(3)	28,006	39,528	39,062	39,045	34,412	33,853	33,474
Total assets	75,526	95,360	91,832	94,227	83,384	80,501	79,537
Short-term debt	6,000	16,927	16,536	9,072	6,827	10,613	6,863
Total current liabilities	20,099	30,179	29,207	22,984	20,385	23,373	19,222
Long-term debt	24,291	27,485	25,950	37,747	33,804	30,852	33,071
Total liabilities	49,216	63,994	61,304	67,874	62,760	59,912	58,358
Total stockholders equity before minority interest	9,549	13,856	13,856	12,729	11,640	16,092	16,390
Total stockholders equity	26,310	31,366	30,528	26,353	20,624	20,589	21,179

**Amounts in accordance with U.S. GAAP:**

Total current assets	22,786	21,599	21,342
Fixed assets, net	24,331	21,503	21,593
Intangible assets, net	45,880	41,170	58,479
Total assets	103,588	92,911	108,093
Total current liabilities	22,725	18,599	23,196
Long-term debt	43,117	38,375	32,586
Total liabilities	76,436	68,314	67,946
Stockholders' equity(7)	13,612	15,224	35,067



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	As of December 31,						As of March 31,	
	2000							
	1999(1)	2000(1)	pro forma (Unaudited) (1)(2)	2001(1)	2002(1)	2003(1)	2003(1)	2004(1)
								(Unaudited)
<b>Financial Ratios in accordance with Italian GAAP:</b>								
Gross operating margin (Gross operating profit/operating revenues)(%)(8)	43.0	43.6	43.1	42.7	44.6	46.3	45.4	47.1
Operating income/operating revenues (ROS) (%)	18.9	18.1	17.9	16.0	19.3	22.0	20.9	24.1
Net debt/Net invested capital (debt ratio)(%)(9)	51.0	54.5	53.9	59.3	61.8	61.8	60.7	59.2
Ratio of Earnings to fixed charges(10)	11.82	2.76	2.87	0.58	0.21	2.55	2.59	3.56
<b>Financial Ratios in accordance with U.S. GAAP:</b>								
Ratio of Earnings to fixed charges(10)				0.71	2.15	3.02		
<b>Statistical Data:</b>								
Subscriber fixed lines in Italy (thousands)(11)	26,502	27,153	27,153	27,353	27,142	26,596	27,107	26,429
ISDN equivalent lines in Italy (thousands)(12)	3,049	4,584	4,584	5,403	5,756	6,027	5,888	6,008
Broadband Access in Italy and abroad (ADSL + XDSL) (thousands)(13)				390	850	2,200	1,100	2,800
Voice Offers in Italy (thousands)(14)				4,094	5,224	5,547	5,392	5,546
Network infrastructure in Italy:								
- access network in copper (millions of km pair)	103.4	104.0	104.0	104.3	104.3	105.2	104.3	105.2
- access network and transport in fiber optics (millions of km of fiber optics)	2.9	3.1	3.1	3.2	3.6	3.6	3.60	3.65
Network infrastructure abroad:								
- european backbone (km of fiber optics)		36,600	36,600	36,600	36,600	39,500	36,600	39,500
TIM lines in Italy (thousands)(15)	18,527	21,601	21,601	23,946	25,302	26,076	25,657	26,036
TIM group foreign lines (thousands)(16)	4,788	7,637	7,637	10,923	13,809	18,438	14,514	21,601
TIM group lines total (Italy + foreign in thousands)(16)	23,315	29,238	29,238	34,869	39,111	44,514	40,171	47,637
GSM penetration in Italy (% of population)	99.2	99.6	99.6	99.7	99.8	99.8	99.8	99.8
E-TACS penetration in Italy (% of population)	97.9	98.0	98.0	98.0	98.0	97.9	97.9	97.9
Page views Virgilio (millions)	505	2,218	2,218	3,945	5,267	6,612	1,641	1,905
Group s employees (at period-end)	129,073	120,973	113,475	116,020	106,620	93,187	104,379	93,036
Group s employees (average number)	128,603	131,266	123,994	113,974	107,079	95,804	99,982	89,083
Operating revenues/Group s employees (average number) (thousands)	219.3	229.4	228.8	280.9	293.3	322.0	72.9	83.3

- (1) Beginning with the consolidated financial statements for the year ended December 31, 2001, under Italian GAAP, Nortel Inversora and the controlled Telecom Argentina group (Nortel Inversora group), which in 2000 were consolidated proportionally, have been accounted for using the equity method. Prior to 2000 the Nortel Inversora group was accounted for on the equity method. Under U.S. GAAP, the Nortel Inversora group is accounted for using the equity method. These differences in accounting treatment for 2000 did not affect net income and stockholders' equity but had an impact on other line items, such as operating revenues and operating expenses, as well as a number of balance sheet line items.



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- (2) The 2000 unaudited pro forma amounts give effect to the consolidation of the Nortel Inversora group using the equity method instead of the proportional consolidation method.
- (3) Beginning in 2003, Telecom Italia changed the manner in which it accounts for bond issuance expenses including them under current assets (prepaid expenses). Previously, such costs were included in Intangible assets, net. Consequently this change also impacted certain statement of operations items. As a result of this change, the previous periods have been reclassified and presented consistent with the 2003 presentation.
- (4) Net income per Share in 1999 is calculated on the basis of 4,812,541,305 shares outstanding, of which 4,721,387,429 Shares, 15,221,888 Preferred Shares and 75,931,988 Savings Shares (net of 2,697,500 Shares of treasury stock acquired from employees in the prior years). Net loss per Share in 2000 is calculated on the basis of 4,700,065,553 Shares outstanding, net of 214,628,828 Shares of treasury stock of which 2,697,500 Shares were held by the Company and 211,931,328 Shares were held by its subsidiary Olivetti International S.A..

Net loss per Share in 2001 is calculated on the basis of 8,569,072,736 Shares outstanding, net of 214,628,828 Shares of treasury stock held by the Company and by its subsidiary Olivetti International S.A.. Net loss per Share in 2002 is calculated on the basis of 8,630,610,804 Shares outstanding, net of 214,628,828 Shares of treasury stock.

Net income per Share in 2003 is calculated on the basis of 15,996,955,942 shares outstanding, of which 10,201,034,873 Shares and 5,795,921,069 Savings Shares; the 10,201,034,873 Shares outstanding are net of 101,208,867 Shares of treasury stock already held by the Company and its subsidiary Olivetti International S.A. resulting from the redistribution of the share capital in connection with the Merger.

The significant changes in share capital compared with the end of 2002 were mainly due to the Merger of Old Telecom Italia into Olivetti, effective from August 4, 2003, which provided for an exchange ratio of 7 Olivetti ordinary shares, par value 1 each, for every ordinary share of Old Telecom Italia, par value 0.55 each, and 7 Olivetti savings shares, par value 1 each for every savings share of Old Telecom Italia, par value 0.55 each. From August 4, 2003, the Shares and Savings Shares of Telecom Italia were issued as a result of the Merger. The change in the number of issued shares in the year 2003 can be analyzed as follows:

- *until August 4, 2003:* (a) issuance of 11,361,740 ordinary shares of which 11,137,324 ordinary shares were issued on conversion of Olivetti 1.5% 2001-2010 convertible bond with redemption premium , 141,134 ordinary shares were issued on the exercise of Olivetti 2001-2002 ordinary share warrants and 83,282 ordinary shares were issued on the conversion of Olivetti 1.5% 2001-2004 convertible bond with redemption premium ; (b) cancellation of 10,958,057 ordinary shares following the exercise of withdrawal rights of dissenting shareholders as permitted in accordance with the terms of the Merger; (c) cancellation of the remaining 8,845,643,315 ordinary shares (including 214,628,828 treasury shares), par value 1 each, to be replaced by new Shares;
- *on and after August 4, 2003:* (a) issuance of 10,287,061,839 new Shares, par value 0.55 each (including 101,208,867 treasury shares), and 5,795,921,069 new Savings Shares, par value 0.55 each, in substitution for the cancelled shares; (b) issuance of 15,181,901 new Shares, of which 11,009,743 shares were issued on the exercise of ex Telecom Italia 1999 Stock Option Plan , 4,028,290 shares were issued on the conversion of Olivetti 1.5% 2001-2010 convertible bonds with redemption premium and 143,868 shares were issued on the conversion of Olivetti 1.5% 2001-2004 convertible bonds with redemption premium .

For more details on changes in stockholders' equity for the years ended December 31, 2001, 2002 and 2003, respectively, please see page F-6, Telecom Italia S.p.A. Statements of Consolidated Stockholders' Equity for the Years Ended December 31, 2001, 2002 and 2003 of our Consolidated Financial Statements included elsewhere herein.

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 shares above dividends paid on the Shares; until July 2000 the par value of ordinary, savings and preferred shares was Lire 1,000 per share. Furthermore, the Extraordinary Shareholders' Meeting of Telecom Italia (formerly Olivetti S.p.A.) held on July 4, 2000 approved the

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conversion of 15,221,888 preferred shares and 78,629,488 savings shares, at par value, into an equal number of ordinary shares. Approval was also given during the same Extraordinary Shareholders Meeting to the free of charge share capital increase by utilizing unrestricted reserves, increasing the par value from Lire 1,000 to Lire 1,936.27 (corresponding to Euro 1) of all the ordinary shares (both issued ordinary shares and shares that would have been issued in the future by implementing the resolutions previously passed with regard to conversion of bonds and the exercise of warrants), with the concurrent redenomination of share capital in Euro. Finally, following the Merger, effective from August 4, 2003, the

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Telecom Italia share capital consists of Shares and Savings Shares. Net income per Savings Share was 1.04 in 1999, 0.08 in 2003 and 0.02 in the first quarter of 2004.

- (5) Telecom Italia's dividend coupons for the year ended December 31, 2003, were clipped on May 24, 2004, and such dividends for the year ended December 31, 2003 were payable from May 27, 2004.
- (6) In accordance with U.S. GAAP, the Net income (loss) per Share has been calculated using the two class method, since the Company has both 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, and diluted earnings per share 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. For the purpose of these calculations, the weighted average number of 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 and the weighted average number of Shares and Savings Shares was 6,620,513,494 and 2,414,967,112 for the year ended December 31, 2003. 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 above dividends paid on the Shares. The calculations take also into account that 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 Shares was 1 per share, and that in 2003, after the Merger, the par value of Shares and Savings Shares was reduced to 0.55 per share. In addition, in accordance with U.S. GAAP, net income (loss) per Savings Share Basic was 0.21 in 2003.
- (7) Stockholders' equity under U.S. GAAP is calculated after elimination of minority interest. See Note 27 of Notes to Consolidated Financial Statements included elsewhere herein.
- (8) Gross Operating Profit was 12,131 million, 13,117 million, 12,216 million, 13,655 million, 14,015 million and 14,280 million in each of 1999, 2000 (historical), 2000 (pro forma), 2001, 2002 and 2003, respectively. Gross Operating Profit was 3,308 million and 3,494 million in the three months ended March 31, 2003 and 2004, respectively. Because Gross Operating Profit includes certain financial statement items and excludes others it is considered a non-GAAP financial measure as defined in Item 10 of Regulation S-K under the 1934 Act. Telecom Italia believes that Gross Operating Profit provides a useful measure of the Telecom Italia Group's operating performance. Gross Operating Profit provides shareholders with an additional level of detail, after operating revenues and before operating income, showing what we believe is an accurate indicator of the Telecom Italia Group's and individual segments' operating results before certain cash and non-cash charges and income arising primarily from ancillary activities. In addition the Telecom Italia Group also believes (although other telecommunications operators will calculate such information differently) that Gross Operating Profit permits an adequate comparison of the Telecom Italia Group's performance against its peer group. Telecom Italia uses Gross Operating Profit, among other measures, as a target for operating performance both internally in our business plan and externally to investors and analysts. As such, Gross Operating Profit is monitored periodically by Telecom Italia management in order to measure Telecom Italia's performance relative to our target. As calculated, Gross Operating Profit is intended to provide shareholders with an operating measure which reflects our consolidated operating revenues less our consolidated operating expenses most directly related to the operations of our business, such as personnel costs. As noted above, Gross Operating Profit eliminates certain cash and non-cash charges which are part of operating our businesses but reflect estimates based on our judgement in applying accounting principles, such as bad debt reserves to cover customers who do not pay their bills, rather than expenses directly related to the operations of our businesses. In addition, Telecom Italia management monitors Gross Operating Profit or similar measures as reported by other telecommunications operators in Italy and abroad, and by other major listed companies in Italy, in order to measure our performance relative to such companies. In certain instances, Gross Operating Profit is also used as a benchmark for purposes of assessing the variable component (i.e., annual bonuses) of our employees' compensation, including in negotiations with our employees' labor unions. Gross Operating Profit is reported in our Italian annual report to shareholders and is used in presentations to investors and analysts. The following table reconciles operating income to the calculation of Gross Operating Profit by showing the Statement of Operation items included in calculating Gross Operating Profit.

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	Year ended December 31,						Three months ended	
	2000						March 31,	
	1999	2000	pro forma (Unaudited)	2001	2002	2003	2003	2004
	(millions of Euro)						(Unaudited)	
Operating income	5,319	5,444	5,079	5,125	6,058	6,789	1,527	1,788
Depreciation and Amortization	6,013	6,946	6,509	7,612	7,227	6,779	1,653	1,590
Other external charges: (*)								
• Provision for bad debts	416	495	412	448	546	471	75	51
• Write-downs of fixed assets and intangibles	88	48	48	17	58	6		1
• Provision for risk	263	154	143	389	114	70	32	12
• Other provisions and operating charges	522	417	388	431	466	485	83	106
Other income (excluding operating grants, reimbursements for personnel costs and costs of external services rendered)	(490)	(387)	(363)	(367)	(454)	(320)	(62)	(54)
<b>Gross Operating Profit . . . . .</b>	<b>12,131</b>	<b>13,117</b>	<b>12,216</b>	<b>13,655</b>	<b>14,015</b>	<b>14,280</b>	<b>3,308</b>	<b>3,494</b>

(\*) The following items included as part of Other external charges are added back to operating income in the calculation of gross operating profit.

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- (9) Net Financial Debt is a non-GAAP financial measure as defined in Item 10 of Regulation S-K under the 1934 Act. Although Net Financial Debt is a non-GAAP measure, it is widely used in Italy by financial institutions to assess liquidity and the adequacy of a company's financial structure. Telecom Italia believes Net Financial Debt provides an accurate indicator of Telecom Italia's ability to meet its financial obligations, represented by gross debt, from its available liquidity, represented by the other items shown in the reconciliation table. Net Financial Debt allows Telecom Italia 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 debt divided by net invested capital, the latter meaning net assets excluding Net Financial Debt). Telecom Italia management believes that Telecom Italia's financial structure is sufficient to achieve our business plan and financial targets. Telecom Italia management monitors the Net Financial Debt and leverage or similar measures as reported by other telecommunications operators in Italy and abroad, and by other major listed companies in Italy, in order to assess our liquidity and financial structure relative to such companies. We also monitor the trends in our Net Financial Debt and leverage in order to optimize the use of internally-generated funds versus funds from third parties. Net Financial Debt is reported in our Italian annual report to shareholders and is used in presentations to investors and analysts. Net Financial Debt is calculated as follows:

	As of December 31,						As of March 31,
	2000						
	1999	2000	pro forma (Unaudited)	2001	2002	2003	2004
	(millions of Euro)						(Unaudited)
Short-term debt, including current portion of long-term debt	6,000	16,927	16,536	9,072	6,827	10,613	6,863
Long-term debt	24,291	27,485	25,950	37,747	33,804	30,852	33,071
<b>Gross debt</b>	<b>30,291</b>	<b>44,412</b>	<b>42,486</b>	<b>46,819</b>	<b>40,631</b>	<b>41,465</b>	<b>39,934</b>
Cash and cash equivalents:							
• Bank and postal accounts	(1,149)	(2,763)	(2,745)	(3,626)	(4,363)	(4,870)	(7,514)
• Cash and valuables on hand	(13)	(8)	(7)	(76)	(7)	(7)	(6)
• Receivables for securities held under reverse repurchase agreements	(133)	(1)	(1)	(4)	(56)	(60)	(12)
Marketable securities(*)	(1,749)	(2,909)	(2,759)	(3,616)	(1,927)	(2,719)	(1,456)
Financial accounts receivable (included under Receivables and Other current assets)	(232)	(1,210)	(1,210)	(894)	(995)	(826)	(446)
Financial prepaid expense/deferred income, net and accrued financial income/expense, net (long-term)		(328)	(328)	(705)	(511)	(307)	(265)
Financial prepaid expense/deferred income, net and accrued financial income/expense, net (short-term)	364	331	292	464	627	670	551
<b>Net Financial Debt</b>	<b>27,379</b>	<b>37,524</b>	<b>35,728</b>	<b>38,362</b>	<b>33,399</b>	<b>33,346</b>	<b>30,786</b>

(\*) In 1999, 2000, 2001 and 2002 data include Old Telecom Italia shares held by Olivetti.

- (10) For purposes of calculating the ratio of earnings to fixed charges:

- earnings is calculated by adding:
  - pre-tax income from continuing operations before adjustment for minority interests in consolidated subsidiaries;
  - fixed charges (as defined below);
  - amortization of capitalized interest and issue debt discounts or premiums;

dividends from equity investees; and  
equity in losses of equity investees;  
and then subtracting:

capitalized interest for the applicable period; and  
equity in earnings of equity investees.



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- fixed charges is calculated by adding:
  - interest costs (both expensed and capitalized);
  - issue costs and any original issue debt discounts or premiums; and
  - an estimate of the interest within rental expense for operating leases.

The term equity investees means investments that Telecom Italia accounts for using the equity method of accounting.

A ratio of less than one indicates that earnings are inadequate to cover fixed charges. The amount by which fixed charges exceeded earnings for the years ended December 31, 2001 and 2002 under Italian GAAP was 1,172 million and 2,037 million, respectively. The amount by which fixed charges exceeded earnings for the year ended December 31, 2001 under U.S. GAAP was 931 million.

- Data include multiple lines for ISDN and exclude internal lines.
- Data exclude internal lines.
- Number of contracts. Broadband access contracts in Italy as of December 31, 2001, 2002 and 2003 were 390,000, 850,000 and 2,040,000, respectively, while as of March 31, 2003 and 2004 were 1,100,000 and 2,575,000, respectively.
- Number of contracts; data include Teleconomy, Hellò and other Business voice offers.
- Data refer to TACS and GSM services lines, including holders of Prepaid Cards.
- The foreign lines include those of mobile telecom affiliates in Turkey and the Czech Republic.

**Dividends**

The determination of Telecom Italia's future dividend policy, and the amounts thereof, will depend upon a number of factors, including but not limited to the Company's earnings, financial condition and cash requirements, prospects and such other factors as may be deemed relevant at the time. Subject to the foregoing, Telecom Italia plans to maintain its dividend over the life of the 2004-2006 Industrial Plan at a level comparable to that paid out for 2003.

*Dividends declared by Old Telecom Italia.* The following table sets forth the dividends per share and per savings share declared by Old Telecom Italia with respect to the last four fiscal years ended December 31, 1999, 2000, 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 Shares			Dividends on Savings Shares		
	Euros per Share	U.S. dollars per Share(2)	(millions of euros)	Euros per Share	U.S. dollars per Share(2)	(millions of euros)
1999(1)	0.3099(3)	0.29	1,638.10	0.3218(3)	0.30	688.58
2000(1)	0.3125	0.27	1,643.93	0.3238	0.28	664.84
2001	0.3125(4)	0.28	1,644.19	0.3237(4)	0.29	662.33
2002	0.1357(5)	0.13	713.47	0.1357(5)	0.13	273.11

- Dividends for 1999 and 2000 were paid in lire. The lire amounts were translated into euros at the irrevocably-fixed rate of exchange of Lit. 1,936.27 = 1.
- Euro amounts have been translated into U.S. dollars using the Noon Buying Rate in effect on the respective payment dates.
- The per share amount paid with respect to the fiscal year ended December 31, 1999 includes the distribution to all shareholders of Old Telecom Italia of the dividends payable on 26,046,820 savings shares held in treasury on the date the dividend was paid. A total of approximately 3.12 million was also distributed from the statutory reserve in order to round up such per share amounts.
- 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 clipped on May 20, 2002 and were payable from May 23, 2002. Dividends for the year ended December 31, 2001 were paid also utilizing reserves.

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- (5) 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.

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*Dividends declared by Telecom Italia (formerly Olivetti).* The following table sets forth the dividends per 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 Shares			Dividends on Savings Shares			Dividends on Preferred Shares		
	Euros per Share	U.S. dollars per Share(2)	(millions of euros)	Euros per Share	U.S. dollars per Share(2)	(millions of euros)	Euros per Share	U.S. dollars per Share(2)	(millions of euros)
1999(1)	0.0310	0.0289	148.92	0.1937	0.1807	15.23	0.0362	0.0338	0.55
2000(1)(3)	0.0350	0.0299	254.87						
2001	0	0	0						
2002	0	0	0						
2003(4)	0.1041	0.1278	1,072.95	0.1151	0.1413	667.11			

- (1) Dividends for 1999 and 2000 were paid in lire. The lire amounts were translated into euros at the irrevocably-fixed rate of exchange of Lit.1,936.27 = 1.
- (2) Euro amounts have been translated into U.S. dollars using the Noon Buying Rate in effect on the respective payment dates.
- (3) On July 24, 2000, the compulsory conversion of the Olivetti savings and preferred shares into Olivetti ordinary shares (approved by the Extraordinary Shareholders Meeting held on July 6, 2000) became effective.
- (4) Approved at the Annual Shareholders Meeting held on May 6, 2004. Pursuant to Italian Stock Exchange rules, dividends on the Shares and the Savings Shares are payable from the fourth business 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, 2003 were clipped on May 24, 2004, and were payable from May 27, 2004.

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.

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 Shares and Saving 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 Description of Bylaws and Description of Capital Stock .

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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 Shares and Savings Shares, as the case may be, in accordance with the relevant Deposit Agreement.

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

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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 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 Shares and Savings Shares, as the case may be, will satisfy these requirements. However, Telecom Italia will be required to provide information concerning non-resident beneficial owners of Ordinary Share ADSs and Savings Share ADSs, 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 Taxation .

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**Item 4. INFORMATION ON THE TELECOM ITALIA GROUP**

**BUSINESS**

**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 STET 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 Major Shareholders 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. Please see Merger with Olivetti. Following the Merger, the proportionate ownership of Telecom Italia's share capital by shareholders unaffiliated with Pirelli S.p.A. (Pirelli), Olimpia's largest shareholder or Olimpia, increased substantially to approximately 88.43% of the outstanding Ordinary Shares. Since that date Olimpia has acquired additional shares through market purchases and Olimpia is currently the largest shareholder of Telecom Italia with approximately a 17% holding of Telecom Italia's Shares.

The share capital of Olimpia is presently held by Pirelli, Edizione Finance International S.A. (hereinafter Edizione), UniCredito Italiano S.p.A. (Unicredito), Banca Intesa S.p.A. (hereinafter Intesa) and Hopa S.p.A. (Hopa) in the following respective proportions: 50.4%, 16.8%, 8.4%, 8.4% and 16%. For a discussion of the relationships between Olimpia's shareholders relating to the Telecom Italia Group, please see Item 7. Major Shareholders and Related-Party Transactions Major Shareholders The Olimpia Shareholders Agreements .

In January 2004, Hopa announced it had acquired a further 3.367% of Telecom Italia's Shares, held, in part, directly (slightly over 0.1%, corresponding to 13,203,484 ordinary shares) and the remaining part through Holinvest S.p.A. (Holinvest), a company owned by Hopa (80.001%) and Olimpia (19.999%).

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On April 6, 2004, Pirelli, pursuant to a call option agreement entered into with JPMorgan in November 2001, exercised its right to buy 47,155,300 Shares at an exercise price per share of 2.12. On April 15, 2004, Holinvest exchanged with JPMorgan Ltd. 95,606,875 of Telecom Italia's convertible bonds for 46,343,969 Shares. After giving effect to the acquisition of the 47,155,300 Shares, Pirelli may be deemed to beneficially own 1,798,921,123 Telecom Italia Shares (including the 1,751,765,823 Telecom Italia Shares beneficially owned by Olympia), representing approximately 17.46% of the total number of Shares reported to be issued and outstanding.

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The following charts illustrate our ownership structure before the Merger and immediately after completion of the Merger.

**Before the Merger**

Note 1: Shareholders of Pirelli & C. S.p.A. with a 5% stake or greater in the voting capital of the company include: Assicurazioni Generali S.p.A. (7.578%); Camfin CAM Finanziaria S.p.A. (36.819%); Fondiaria-SAI S.p.A. (5.618%); RAS S.p.A. Riunione Adriatica Di Sicurtá (5.075%); Mediobanca S.p.A. (5.075%); Edizione Holding S.p.A. (6.027%) and RCS Media Group S.p.A. (6.006%).

Shareholders of Pirelli S.p.A. with a 5% stake or greater in the voting capital of the company include: Pirelli & C. Luxembourg S.p.A. (27.506%); Pirelli & C. S.p.A. (14.194%); Pirelli S.p.A. (8.508%); and Landesbank Baden-Wuerttemberg (5.553%).

Shareholders of Camfin CAM Finanziaria S.p.A. with a 5% stake or greater in the voting capital of the company include: Mr. Tronchetti Provera (through Gruppo Partecipazioni Industriali S.p.A.) (57.472%); and F.G.F. Financiere Gazzoni Frascara SA (9.331%).

Shareholding percentages in Pirelli & C. S.p.A., Pirelli & C. S.p.A. and Camfin CAM Finanziaria S.p.A. are extracted from publicly available filings with CONSOB as of June 30, 2003.



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### **On completion of the Merger**

Note 2: 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. (23.732%).

Shareholders of Camfin CAM Finanziaria S.p.A. with a 5% stake or greater in the voting capital of the company include: Mr. Tronchetti Provera (through Gruppo Partecipazioni Industriali S.p.A.) (57.564%); and F.G.F. Financiere Gazzoni Frascara SA (9.331%).

Shareholding percentages in Pirelli & C. S.p.A. and Camfin CAM Finanziaria S.p.A. are extracted from publicly available filings with CONSOB as of December 31, 2003.

A glossary of selected telecommunications terms used in the following description of the Telecom Italia Group's business and elsewhere in this Annual Report can be found at the end of Item 4 of this Annual Report.

### **General**

At the end of 2003, the Telecom Italia Group was one of the world's largest fixed telecommunications operators, with approximately 26.6 million subscriber fixed-lines installed (including ISDN) equivalent lines. Through our subsidiary TIM, we were also the largest mobile telecommunications operator in Italy and one of the largest in the world, with more than 44.5 million mobile lines which includes 26.1 million lines in Italy and more than 18.4 million outside Italy through controlled and associated companies of TIM (35.6 million lines in which we have an economic interest or proportionate lines). At December 31, 2003, we also had 6.6 million mobile lines (2.2 million proportionate lines) through companies indirectly owned through Telecom Italia International. In Italy TIM is one of three operators with the right to provide GSM digital mobile telecommunications services and one of three operators with the right to provide DCS 1800 digital mobile telecommunications services (the fourth operator, Blu, was acquired in October 2002 and merged into TIM in December 2002). TIM is one of five entities which have acquired a UMTS license to provide third generation mobile services in Italy.

The Telecom Italia Group also provides leased lines and data communications services, internet services including broadband, and IT software and services. We also operate in the office products, IT office products and specialized applications for service automation in banking retail, gaming and public authorities services and specialized automation systems sector through Olivetti Tecnost.

Our international portfolio of subsidiaries and investments includes fixed and mobile telecommunications companies which operate mainly in Latin America and certain countries in Europe.

### **Significant Developments during 2003**

*Merger with Olivetti*

Olivetti was established in Ivrea (Turin) in 1908 as a typewriter manufacturer. Over time, Olivetti shifted the focus of its core business from mechanical office products to electronic equipment, computers, IT systems and services and during the 1990s, to telecommunications. In May 1999, Olivetti and its subsidiary Tecnost

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S.p.A. ( Tecnost ) successfully made a joint tender offer for Old Telecom Italia which ultimately resulted in Olivetti obtaining a 54.94% controlling interest in Old Telecom Italia's ordinary shares. The acquisition of Old Telecom Italia marked a major development in the transformation of Olivetti's core businesses.

In May 2003, the shareholders of Olivetti and of Old Telecom Italia approved the Merger of Old Telecom Italia with and into Olivetti with Olivetti as the surviving company. The Merger was part of a strategic plan pursued by Olivetti, as majority owner of Old Telecom Italia, with the aim of focusing on core businesses, improving its corporate structure and reducing debt. Prior to the Merger and the cash tender offers described below, Olivetti had a 54.94% controlling interest in Old Telecom Italia which was Olivetti's largest subsidiary (representing approximately 96.8% of its operating revenues in 2002). The Merger became effective on August 4, 2003, at which time 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 1934 Act. Telecom Italia completed the listing of its Ordinary Share ADSs and Savings Share ADSs on the New York Stock Exchange concurrently with the completion of the Merger. Telecom Italia's Shares and Savings Shares are also listed on the automated screen-based trading system (Mercato Telematico Azionario) of Borsa Italiana.

In connection with the Merger, the following transactions occurred:

- Olivetti shareholders who either voted against the Merger or did not attend the shareholders' meeting held on May 26, 2003, benefited from a withdrawal right of 0.9984 per share (which was the arithmetic mean of the daily official share price of the Olivetti shares in the six months preceding the date the Merger resolution was adopted; such date was May 26, 2003). Olivetti shareholders were entitled to such a right by law due to the change in the corporate objectives of Olivetti which, following the completion of the Merger, changed its name to Telecom Italia S.p.A.. Olivetti shareholders exercised such right with respect to 10,958,057 shares representing 0.12% of the outstanding ordinary shares. Olivetti shareholders received an aggregate payment of 10,940,524 when the Merger became effective.
- Voluntary cash tender offers by Olivetti for a portion of the outstanding Old Telecom Italia ordinary shares and savings shares were made in connection with the Merger (although the cash tender offers were not made to savings shareholders in the United States). Olivetti tendered for 908,873,776 (17.3%) of Old Telecom Italia ordinary shares (including those represented by ADSs) and 354,560,274 (17.3%) of the Old Telecom Italia savings shares. Olivetti acquired approximately 9.73% and 11.83% of the Old Telecom Italia ordinary shares and savings shares, respectively, through the cash tender offers. Aggregate consideration paid after the Merger became effective was 5,274 million.

In connection with financing the withdrawal right and the cash tender offers, Olivetti entered into a Term Loan Facility with a syndicate of banks pursuant to which it borrowed 5,274 million with respect to the above transactions. Olivetti also entered into a 6.5 billion Revolving Credit Facility to provide funds for working capital and general corporate purposes which replaced Old Telecom Italia's 7.5 billion facility which was cancelled.

As a result of, and immediately after, the Merger, the proportionate ownership of Telecom Italia's ordinary share capital by shareholders unaffiliated with Olimpia or its principal shareholder Pirelli increased substantially from 45.06% to 88.43% of Telecom Italia's outstanding Ordinary Shares. Olimpia owned 11.57% of Telecom Italia's ordinary share capital immediately following the Merger. On October 15, 2003, Olimpia announced that it had acquired an additional 266.3 million Ordinary Shares of Telecom Italia representing approximately 2.6% of Telecom Italia's ordinary share capital. After such acquisition, Olimpia held approximately 14.16% of Telecom Italia's ordinary share capital. The Olimpia Shareholders Meeting, held on November 13, 2003, approved a capital increase of up to 770 million, most of which (approximately 700 million) has been used to purchase Telecom Italia Ordinary Shares. Consequently, on December 18, 2003, Olimpia's holding of Telecom Italia ordinary share capital increased to approximately 17%. Olimpia is Telecom Italia's largest shareholder.

*SEAT Spin-off and Sale*

On April 1, 2003, the Board of Directors of SEAT approved the proposed proportional spin-off of the directories and almost all of the directory assistance and business information business segments of SEAT into New SEAT, a newly incorporated company which assumed the current name of Seat Pagine Gialle S.p.A. .

Effective as of August 1, 2003, the date of the spin-off, the corporate name of the remaining part of SEAT became Telecom Italia Media S.p.A. . The spin-off plan was approved by a SEAT extraordinary shareholders meeting held on May 9, 2003.

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The shares of both companies are listed on the automated screen-based trading system (Mercato Telematico Azionario) of Borsa Italiana. The spin-off created two independent companies, each focused on its core businesses. It was SEAT management's view that SEAT operated in two broad market sectors that had increasingly developed separate and distinct characteristics in terms of strategy, operations and competitive landscape.

The first sector targeted advertising and telephone services, in which SEAT operated through its directories, directory assistance and business information segments, providing answers to queries via printed, online and telephone products and services. The second sector was traditional advertising and the internet, in which SEAT operated through its internet, TV and other business segments, primarily providing access and content services. In SEAT management's view, both sectors presented interesting development prospects (including broadband access and digital TV).

The strategic objective of the spin-off was to allow SEAT's businesses in each of the two sectors to more rapidly respond to market developments and exploit market opportunities, with a more focused management and a resource allocation consistent with the development prospects of each business line.

The spin-off provided for the transfer to New SEAT of the following companies within the directories, directory assistance and business information business segments of SEAT:

- *Directories:* Directory Italia Seat Pagine Gialle S.p.A. division, Annuari Italiani S.p.A., Euredit S.A., TDL Group, Euro directory S.A..
- *Directories Assistance:* Directories Assistance Seat Pagine Gialle division, Telegate Group, Telegate Holding GmbH, IMR S.r.l..
- *Business Information:* Consodata S.A., Consodata Group Ltd (including Netcreations Inc., Pan Adress).

The other companies and business segments remained with Telecom Italia Media.

### ***Sale of Telecom Italia's stake in New SEAT***

On June 10, 2003, Old Telecom Italia and a consortium of investors formed by BC Partners, CVC Capital Partners, Investitori Associati and Permira (Silver S.p.A.) entered into a sale and purchase agreement for the sale of approximately 61.5% of the share capital of New SEAT which, at the time of the agreement, the Telecom Italia Group was expected to receive after the spin-off transaction creating New SEAT, including the shares resulting from the exercise of the JP Morgan Chase put option for which Telecom Italia paid 2,272 million. The JP Morgan Chase put option relates to certain put/call arrangements entered into by Telecom Italia at the time of its original acquisition of SEAT. In connection with the spin-off and sale of New SEAT, the JP Morgan Chase put option was closed out and will have no impact on Telecom Italia's business. See Note 18 of Notes to Consolidated Financial Statements included elsewhere herein. For a discussion of the impact of the JP Morgan Chase put option on net financial debt, see Item 5. Operating and Financial Review and Prospects Liquidity and Capital Resources Capital Resources Net Financial Debt. The parties agreed on a sale price of 0.598 per New SEAT ordinary share, representing an enterprise value of approximately 5.65 billion and a price for Telecom Italia's stake of 3.033 billion. The sale was completed on August 8, 2003. Taking into account New SEAT's net financial indebtedness at the date of finalization of the sale (648 million), the transaction allowed Telecom Italia to reduce its net financial consolidated debt by 3,681 million.

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The agreements relating to the sale of Telecom Italia's stake in New SEAT include Telecom Italia's undertaking to provide, on an ongoing basis, Telecom Italia Media with the funds necessary to service Telecom Italia Media's debt and other liabilities in existence as of the date of the SEAT spin-off. The undertaking provides for Telecom Italia Media to have funds sufficient to meet such liabilities and that New SEAT be indemnified from potential liabilities vis-à-vis any creditors of Telecom Italia Media deriving from New Seat's statutory joint liability for such obligations.

As a result of the sale, on July 31, 2003, Telecom Italia and Pagine Italia agreed not to execute the agreements reached in September 2002, regarding the purchase by Telecom Italia of the assets of the Pagine Utili directories. Telecom Italia agreed to pay 55 million to Pagine Italia in connection with the termination of such agreement.

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### *Notes Issue*

On October 10, 2003, as part of the plan to refinance short and long-term borrowings falling due, the Board of Directors of Telecom Italia authorized the establishment of a 10 billion Euro Medium Term Note Program (the Euro MTN Program). These notes will be issued, when market conditions permit, by Telecom Italia and/or its subsidiary Telecom Italia Finance, with a guarantee by Telecom Italia.

On the same date, the Board of Directors also approved the undertaking by Telecom Italia of a guarantee for the issue of notes to be placed with qualified institutional buyers principally in the United States of America pursuant to Rule 144A of the U.S. Securities Act of 1933, for a maximum amount of U.S.\$4 billion. As a consequence of this resolution, on October 29, 2003, Telecom Italia Capital S.A. (a wholly-owned finance company of Telecom Italia) finalized the issue of fixed-rate multi-tranche notes in U.S.\$, with a full and unconditional guarantee by Telecom Italia.

Such notes included:

- Series A notes in the principal amount of U.S.\$1 billion, with an annual fixed rate coupon of 4%, issue price of 99.953%, maturing November 15, 2008;
- Series B notes in the principal amount of U.S.\$2 billion, with an annual fixed rate coupon of 5.25%, issue price of 99.742%, maturing November 15, 2013;
- Series C notes in the principal amount of U.S.\$1 billion, with an annual fixed rate coupon of 6.375%, issue price of 99.558%, maturing November 15, 2033.

On December 18, 2003, as part of the plan referred to above, the Board of Directors passed a resolution to issue notes under the Euro MTN Program during 2004 up to an aggregate amount of 5.1 billion.

## **Disposition and Acquisition of Significant Equity Investments in 2003**

### *Dispositions*

***Sale of Telekom Srbija.*** On February 20, 2003, Telecom Italia International N.V. executed a Share Purchase Agreement, for the sale of its entire participation in Telekom Srbija, corresponding to 29% of the Telekom Srbija share capital for a total consideration of 195 million. The payment of the first tranche of 120 million was completed in June 2003 and the closing occurred on July 7, 2003. The shares will remain in an escrow account until full payment of the remaining 75 million, which constitutes the second tranche of the transaction, is made.

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***Dedalo project.*** In January 2003, the Telecom Italia Group completed the early purchase of 12 property units (approximately 300,000 square meters) from Teleleasing S.p.A. that are leased by Telecom Italia S.p.A. and other Telecom Italia Group companies. The transaction involved a total financial payment of approximately 369 million by the entire Telecom Italia Group.

Following a binding offer by Beny Steinmetz Group through its subsidiary Five Mounts Property (FMP), on June 20, 2003, Telecom Italia formalized an agreement with Lastra Holding B.V. (FMP Group) for the transfer of most of the early purchased property units, with a sale price of 355 million. At that time Telecom Italia delivered executed lease agreements on the same units to guarantee their utilization.

On June 30, 2003, the property units were transferred into a vehicle company, FMP Italy 1 s.r.l., 100% owned by Telecom Italia (FMP Italy). On July 21, 2003, the entire FMP Italy stake was transferred from Telecom Italia to Lastra Holding B.V. for 45,000. On the same date, Telecom Italia, TIM and Atesia received the purchase price for the property units from FMP Italy.

### ***Acquisitions***

***Acquisition of Consodata shares.*** On February 12, 2003, Seat Pagine Gialle acquired 1,108,695 ordinary shares in the French subsidiary Consodata S.A. listed on the Paris Nouveau Marché stock exchange after the founding shareholders exercised their option to sell, which was granted to them under an agreement made with previous Seat Pagine Gialle management on July 31, 2000. This transaction, undertaken at an agreed consideration of 44 per share for a total of approximately 48.8 million resulted in Seat Pagine Gialle acquiring a further 8.17% of the company share capital and voting rights, thereby raising its stake in Consodata S.A. to 98.60%. Consodata was among the companies included in the business information business segment of SEAT which was spun-off and later sold.



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***Acquisition of HanseNet.*** In September 2003, the acquisition from e.Biscom of 100% of HanseNet Telekommunikation GmbH ( HanseNet ), a broadband operator in the Hamburg area, was finalized by Telecom Italia for a total investment of 243 million. To this end, Telecom Italia had previously purchased the company Telecom Italia Deutschland GmbH which was used to purchase the entire investment in HanseNet.

### **Recent Developments during 2004**

#### ***Sale of shares in Telekom Austria***

On January 27, 2004, Telecom Italia International sold through a private placement agreement its remaining shares in Telekom Austria, representing 14.78% of Telekom Austria's total share capital. Gross proceeds were 780 million (approximately 770 million, net of commissions paid to banks) realizing a net gain at the consolidated level of 62 million.

#### ***Sale of shares in Euskaltel***

On January 16, 2004, a contract was signed with Araba Gertu S.A. for the sale, by Telecom Italia International, of a 3.1% stake in Euskaltel, the regional operator for cable TV and applied telecommunications for Basque countries, for a total price of 13.6 million. The closing took place on February 19, 2004, after the deadline had passed for the exercise of pre-emption rights on the shares held by the other shareholders. The pre-emption right was exercised by the shareholder, Iberdrola and, accordingly, the sale of the shares held by Telecom Italia International occurred through the signing of two separate contracts (149,231 shares sold to Araba Gertu for a consideration of 12.1 million and 18,719 shares sold to Iberdrola for a consideration of 1.5 million). Upon completion of the transaction, Telecom Italia International retained a 3% stake in Euskaltel.

#### ***TIM's stake in Digitel***

On April 19, 2004, TIM International agreed to settle several lawsuits between TIM International and all the other shareholders of Corporacion Digitel C.A. ( Digitel ). The lawsuits concerned the covering (which was performed in 2003) of losses for the fiscal year 2002. According to the terms of the settlement, TIM International agreed to acquire the shares held by all the other shareholders (corresponding to 32.88% of Digitel's share capital) for U.S.\$110 million. As a consequence of the settlement, TIM International will have total control of the Venezuelan company. The effectiveness of the settlement is subject to certain conditions, the most important of which are: the waiver by all the other shareholders to any further request or lawsuit against TIM/Digitel, and the dismissal of the arbitration proceeding initiated in New York (under the International Chamber of Commerce's rules) between TIM International and Venconsul. The difference between the fair market value of the shares to be acquired and the acquisition price agreed to in the settlement has been covered by a reserve for risks and charges.

#### ***Decrease in share capital of Solpart Participações ( Solpart )***

At the Extraordinary Shareholders' Meeting of Solpart, the holding company of Brasil Telecom Participações ( Brasil Telecom ), a provider primarily of fixed line telecommunications services in Rio Grande do Sul, Paraná, Santa Catarina, Mato Grosso do Sul, Mato Grosso, Rondônia,

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Acre, Goiás, Tocantins, Distrito Federal (Brasilia) of Brazil, held on April 26, 2004, a capital reduction was approved amounting in the aggregate to \$Reais 173,350,000.00 of which (i) \$Reais 41,898,263.09 is to be proportionally reimbursed to the shareholders in cash and (ii) the proportionally delivery to the shareholders of 3,474,342,842 ordinary shares and 3,491,253,373 preferred shares of its affiliate Brasil Telecom Participações. The valuation of the capital reimbursement through the delivery of shares was made on the basis of the weighted average price at the fixing of Sao Paulo s Stock Exchange on April 23, 2004. The weighted average price was \$Reais 17.65 based on the value of the trading lot (1,000 shares) for the ordinary shares, \$Reais 19.52 for the same lot of preferred shares and \$Reais 1,980,319.91 to cover previous period losses. The sole purpose of the capital reduction was to permit Solpart to pay a dividend to its shareholders.

As a consequence of the events described under (i) and (ii) above, Telecom Italia International is entitled to receive \$Reais 15,917,669.18 in cash, 1,319,945,886 ordinary shares and 1,326,370,406 preferred shares. The transaction will have no effect on the overall control of Brasil Telecom or its normal business operations.

### *Agreement for the sale of GPP*

On May 13, 2004, Telecom Italia Media reached an agreement with Wise Venture Sgr, the company that manages the Wisequity closed-end equity fund, in relation to the disposal of 100% of GPP S.p.A., the parent company of the publishing groups Quasar s.r.l., JCE S.p.A. and Faenza Editrice S.p.A..

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The disposal of GPP S.p.A. represents yet another step in the process of rationalization of Telecom Italia Media's asset portfolio. Following this transaction, Telecom Italia Media exits the professional publishing sector, which is not considered synergic with its core business.

The disposal is based on the assessment of the overall enterprise value of GPP S.p.A. valued at 14.6 million. The sale will improve the Group's net financial standing by approximately 13.8 million. The transaction is expected to be completed within the first half of 2004.

**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, 2003:

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

		Wireline		South America	Internet and Media	IT Market	IT Group	Olivetti Tecnost		Other activities and eliminations	Consolidated Total
		(1)(3)	Mobile	(4)	(5)	(3)	(3)	Tecnost	Sub-total	(3)(6)	Total
(millions of Euro, except number of employees)											
Gross operating revenues	2003	17,216	11,782	1,126	1,297	891	1,100	655	34,067	(3,217)	30,850
		17,047	10,867	1,409	1,991	1,039	996	914	34,263	(2,855)	31,408
	2002(2)	17,174	10,250	1,534	1,957	1,322	1,039	1,097	34,373	(2,357)	32,016
	2001(2)										
Gross operating profit (7)	2003	8,255	5,502	400	322	84	96	40	14,699	(419)	14,280
		7,951	5,039	450	593	114	98	59	14,304	(289)	14,015
	2002(2)	7,730	4,760	527	444	181	198	27	13,867	(212)	13,655
	2001(2)										
Operating income	2003	4,969	3,786	137	63	58	(36)	2	8,979	(2,190)	6,789
		4,677	3,358	146	232	64	(40)	4	8,441	(2,383)	6,058
	2002(2)	4,338	3,136	187	31	133	51	(26)	7,850	(2,725)	5,125
	2001(2)										
Capital expenditures	2003	2,302	1,957	130	102	30	174	20	4,715	179	4,894
		2,475	1,715	216	81	39	149	35	4,710	191	4,901
	2002(2)	2,842	3,151	406	175	33	139	62	6,808	423	7,231
	2001(2)										
Number of employees at the year end	2003	50,766	18,888	5,049	2,029	4,827	4,107	2,395	88,061	5,126	93,187
		53,935	18,702	5,461	7,715	5,506	5,039	4,527	100,885	5,735	106,620
	2002(2)	58,112	16,721	5,746	9,264	7,454	5,127	4,896	107,320	8,700	116,020
	2001(2)										

- (1) As of June 16, 2003, Domestic Wireline changed its name to Wireline.
- (2) The data relating to 2002 and 2001 have been reclassified and presented consistent with the 2003 presentation.
- (3) Starting from January 1, 2003, the Netikos group, the Webegg group, the TILab, Loquendo and Eustema are no longer consolidated by the IT Group Operating Activity. BBNet is no longer included in Other Activities. The TILab moved to Other activities and Loquendo and BBNet became part of Wireline, whereas the other companies moved to the IT Market Business Unit. The effects of such reclassifications were not material.
- (4) The data refer to Entel Chile group, Entel Bolivia group, the company Telecom Italia America Latina and the business segment South America of Telecom Italia. See Item 5. Operating and Financial Review and Prospects Recent Developments Telecom Italia Group Results for the First Quarter Ended March 31, 2004, compared to March 31, 2003.
- (5) New SEAT, the beneficiary company of the spin-off from Seat Pagine Gialle which took place on August 1, 2003, was sold on August 2003. As a result of this, the 2003 figures include the results of operations for the first seven months of New SEAT Group, as well as the

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results of operations for the entire year of the remaining part of Seat Pagine Gialle that after the spin-off was renamed Telecom Italia Media.

- (6) The data include the operations of the International Affairs Corporate Function, the TILab, the Old Business Unit Satellite Services (the Telespazio group) which was disposed of during the fourth quarter of 2002 and consolidated in the statement of operations only for the first nine months of 2002 the 9Telecom group sold in the third quarter of 2002 and for which only the statement of income data was consolidated for the first six months of 2002 as well as the financial companies, the centralized group services and the staff functions.
- (7) For an explanation of Gross Operating Profit and a reconciliation to Operating Income on a consolidated basis, See Item 3. Key Information Selected Financial and Statistical Information Note 8 . For a reconciliation of each segment s Gross Operating Profit to each segment s Operating Income. See Notes to Consolidated Financial Statements Note 25(a) Segment Information .

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

	Year ended December 31,		
	2001	2002	2003
<b>Subscription and Customers:</b>			
Subscriber fixed-lines at period-end in Italy (thousands)(1)	27,353	27,142	26,596
Subscriber fixed-line growth per annum in Italy(%)	0.7	(0.8)	(2.0)
ISDN equivalent lines at period-end in Italy (thousands)(2)	5,403	5,756	6,027
Broadband Access in Italy and abroad (ADSL + XDSL) (thousands)(3)	390	850	2,200
Voice Offers in Italy (thousands)(4)	4,094	5,224	5,547
Network infrastructure in Italy:			
access network in copper (millions of km pair)	104.3	104.3	105.2
access network and transport in fiber optics (millions of km of fiber optics)	3.2	3.6	3.6
Network infrastructure abroad:			
European backbone (km of fiber optics)	36,600	36,600	39,500
TIM lines in Italy at period-end (thousands)	23,946	25,302	26,076
TIM group foreign lines (at period-end, thousands)(5)	10,923	13,809	18,438
TIM group lines total (Italy + foreign, thousands)(5)	34,869	39,111	44,514
TIM lines in Italy growth per annum(%)	10.9	5.7	3.1
Average revenue in Italy per mobile line per month( ) (6)	29.1	28.8	29.1
Cellular penetration in Italy at period-end (TIM lines per 100 inhabitants)(%)	41.6	43.9	45.3
Cellular market penetration in Italy at period-end (lines for the entire market per 100 inhabitants)(%)	89.0	93.7	99.2
GSM penetration in Italy (% of population)	99.7	99.8	99.8
E-TACS penetration in Italy (% of population)	98.0	98.0	97.9
<b>Retail Traffic(7):</b>			
Average minutes of use per fixed-line subscriber in Italy during period(8)	4,739	4,292	4,127
Of which:			
Local traffic during period (in average minutes)(9)	3,575	3,198	2,971
Long-distance traffic during period (domestic and international) (in average minutes)	1,163	1,094	1,156
Total mobile outgoing traffic per month (millions of minutes)	1,795	1,960	2,090
<b>Internet and Media:</b>			
Page Views Virgilio (millions)	3,945	5,267	6,612

- (1) Data include multiple lines for ISDN and exclude internal lines.
- (2) Data exclude internal lines.
- (3) Number of contracts. Broadband access contracts in Italy as of December 31, 2001, 2002 and 2003 were 390,000, 850,000 and 2,040,000, respectively.
- (4) Number of contracts; includes Teleconomy, Hellò and other Business voice offers.
- (5) The foreign lines include those of the mobile telecommunications affiliates in Turkey and the Czech Republic. Our proportionate share results in total lines of 35.6 million as of December 31, 2003.
- (6) Including Prepaid Customers' revenues and excluding equipment sales and including non-TIM customer traffic.
- (7) Retail traffic consists of traffic from Telecom Italia customers for local calls, long distance national and international calls (including calls to mobile phones).
- (8) Includes total fixed outgoing traffic (including international outgoing traffic and fixed outgoing traffic to the mobile networks).
- (9) Including district and internet dial-up traffic.

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### **Updated Business Plan and Strategy**

#### *Updated Business Plan*

On March 25, 2004, we announced our 2004-2006 Industrial Plan (the 2004-2006 Industrial Plan ) and established our priorities. The main objectives are to:

- consolidate our leadership in the domestic wireline market by increasing customer loyalty through innovative offers and stimulating the market for value added and broadband contents and services, with special reference to ADSL technology. ADSL is a telecommunications technology that permits the transmission of data and allows access to the Internet at very high speeds;
- in the mobile market, increase traffic volumes and develop value added services in line with user expectations (MMS, or Mobile Multimedia Services, mobile TV, gaming, videostreaming, videotelephony) and leveraging on technology integration (GSM/EDGE/UMTS);
- in the Internet and Media sector, continue the development of broadband services and portals and strengthen our television channels (La7 and MTV Italia) and launch Digital Terrestrial TV services;
- expand our presence abroad in markets where we can capitalize on our marketing and technological know-how: in the mobile business, in Latin America and especially in Brazil and, in the wireline business, through the development of broadband services in Europe;
- continue to manage our operations according to rigorous criteria of efficiency, relying on synergies deriving from the organizational model based on so-called professional families and service centers, cost control systems (completing the cost efficiency target), and the careful selection of investment projects, aimed primarily at fostering innovation and sustainable growth;
- complete the cost efficiency targets of the 2002-2004 plan and further improve cost efficiency. At December 31, 2003, we had achieved 86% of the 2002-2004 announced target of cost reductions of 2.6 billion through the reduction of both operating expenses and capital expenditures; and
- strengthen our financial structure through strong cash generation.

The 2004-2006 Industrial Plan takes into account the changes in the scope of consolidation (including the sale of New SEAT) and is substantially a confirmation of the plans which have been implemented by Olivetti and Old Telecom Italia since 2002. In addition to debt reduction, the Old Telecom Italia Group sought to strengthen its competitive position in its core domestic market and sustain profitable growth through the introduction of new products and services in its main business areas over the past two years.

#### *Wireline*

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In Wireline, over the past two years a principal focus has been on broadband and loyalty programs. At the end of 2003, the customer base of broadband accesses was 2,040,000 in the domestic market and 160,000 in the European market (France, Germany and the Netherlands). New services for broadband Internet (Alice and Smart) have supported continued growth. New voice packages and innovative integrated solutions for business clients were also introduced.

The Telecom Italia Group's wireline strategy continues to be driven by defense of market share in voice traffic, strong emphasis on data/internet growth and broadband contents and services development, and focus on obtaining continuing efficiencies and levels of capital expenditures.

In particular, we intend to:

- maintain our domestic leadership in our core business (voice services, internet access, data transmission services for businesses, national and international wholesale services);
- 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 billing, customer relations management (CRM) and customer contact);
- concentrate on developing value added services, both for corporate and residential customers, to sustain revenue and margin levels, building, in particular, on the increasing penetration of internet and broadband contents and services (including WiFi), but also on innovation in voice and videocommunication services and terminals, equipped with new facilities, similar to mobile phone functions;



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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 and innovation such as optical transport and IP (Internet Protocol) services; and
- expand the wireline broadband offer in selected areas throughout Europe (such as Germany and France) with the creation of facility-based operators providing broadband access and value-added services by capitalizing on domestic expertise.

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

## ***Mobile***

Mobile, over the past two years, has developed new offerings of both voice and multimedia services (messaging, gaming and videostreaming), and voice portals together with the launch of specialized packages for business.

TIM's strategy is focused on maintaining its leadership and achieving sustainable growth in the wireless market by focusing on customers with high mobile phone usage, in particular through:

- continuous innovation in voice and Value Added Services (VAS) offers;
- strong customer care able to respond and anticipate customer needs;
- constant focus on technological innovation to match market expectations, exploiting the potential of the GPRS/EDGE/UMTS network integration; and
- further development of GSM services in Brazil and acquisition of leadership in the GSM Latin American market.

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

- innovative marketing, aimed at generating new and tailored offers to increase voice traffic and VAS utilization;
- a multichannel and integrated approach to caring and distribution, tailored for different customer needs/profile;
- a plug and play system to share resources and know-how via a centralized support of local networks in different countries;

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- establishment of FreeMove , an alliance with leading wireless operators to launch new products and services, achieve efficiency through joint procurement of services and develop a Multinational Pan-European offer;
- excellence in human resources, through recruitment, development and retention of key human resources, analysis and selection of methods for increasing flexibility of resources and the management of internal innovation process; and
- profitability and cash flow generation, through maintenance of high efficiency levels on its network, IT and back-office, investments and working capital control.

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

### ***Internet and Media***

Internet & Media launched a new broadband portal and redesigned the programs list of La7 (the Internet and Media business unit television station).

### ***International Activities***

The 2004-2006 Industrial Plan also provides for the development of our international activities including the expansion of broadband services in Europe, leveraging of our presence and technological leadership in Brazil, increasing market share in high-end segments in Greece and consolidating our presence in Turkey.

**Table of Contents****Capital Expenditures**

Capital expenditures will be directed towards reinforcing our strategy with a focus on:

- innovation;
- continuing leadership in the domestic market;
- strengthening existing international assets; and
- development of value added services.

The industrial investments planned for the three years 2004-2006 will be approximately 15 billion, in line with the forecast for the three years 2003-2005. The breakdown by sector of activity is shown in the table below.

	<b>Approximate % of Industrial Investments</b>
Wireline	42%
Mobile	47%
Internet and Media	1%
Other	10%

**Financial Targets**

With respect to strengthening our financial structure, consolidated net financial debt (see Note 9 to Selected Financial and Statistical Information under Item 3. Key Information Selected Financial and Statistical Information which reconciles our net financial debt to our gross debt) of 33.3 billion as of December 31, 2003, meant that we had, post Merger, maintained the level of net financial indebtedness of Olivetti at December 31, 2002, despite the early exercise of the JP Morgan Chase put option associated with the SEAT demerger ( 2.3 billion) and the incurrence of 5.3 billion of indebtedness to finance the withdrawal right and cash tender offers associated with the Merger. We were able to maintain the level of net financial indebtedness by repayment of debt with significant free cash from our operations as well as net proceeds of approximately 3.8 billion from the disposition of assets. Although our net financial indebtedness has remained relatively constant year-on-year, this nonetheless represents a significant increase over the 18.1 billion of net financial indebtedness of the Old Telecom Italia Group at December 31, 2002. We have established a target of reducing our net financial indebtedness below 30 billion by the end of 2004.

Our 2004-2006 Industrial Plan also establishes certain financial targets. The financial targets (based on Italian GAAP) include:

**Objectives of Telecom Italia  
on a consolidated basis-CAGR(1)**

2004-2006

Operating revenues	>5%
Gross operating profit	>5.5%(2)
Operating income	>10%
Net financial debt by Year End 2004 ( in billions)	<30billion(3)

- (1) Compound average growth rate. Assumes no change in scope of consolidation and excludes exchange rate impact.
- (2) For a description of Gross Operating Profit, see Item 3. Key Information Selected Financial and Statistical Information .
- (3) At December 31, 2004. For a description of Net Financial Debt, see Item 3. Key Information Selected Financial and Statistical Information .

*Please see Cautionary Statement for Purposes of the Safe Harbor Provisions of the United States Private Securities Litigation Reform Act of 1995 at the beginning of this Annual Report for a discussion of factors which could cause our actual results to differ materially from the targets discussed above. See, also, Item 3. Key Information Risk Factors . There can be no assurance that we will be able to achieve the financial targets we have established under our 2004-2006 Industrial Plan.*

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### **The Organizational Structure**

Telecom Italia Group's organizational structure includes:

- Corporate Functions, which are responsible for the Telecom Italia Group's operations; and
- Business Units, which are responsible for business development and managing operations for external markets.

The following diagram highlights the organizational structure of the Telecom Italia Group as of June 4, 2004.

- 
- (1) Consortium company which carries out Internal Auditing activities in the Telecom Italia Group.
  - (2) The International Legal Affairs function, previously under Corporate and Legal Affairs, has, since February 23, 2004, reported directly to the CEO Carlo Buora. It has responsibility for providing support to top management of the Telecom Italia Group with respect to legal issues concerning international operations and development of the business, together with Corporate and Legal Affairs which ensures the coordination on such issues at the Telecom Italia Group level.
  - (3) On March 1, 2004, the Latin America Operations function was disbanded. This function was set up in 2002 and reported to the head of the Mobile Business Unit for mobile telecommunications and to the CEO Carlo Buora for wireline telecommunications and was responsible for the global coordination of all the activities of the Group in Latin America. Telecom Italia Latam S.A. has now taken over the new role of the delocalized Corporate function in Latin America, consistent with the Telecom Italia Group's chosen strategy to consolidate and develop its international presence in the Latin America geographical area. The Business Units with their present corporate organizational structure are nevertheless responsible for the results of the subsidiaries in Latin America under their control.

On March 1, 2004, Paolo Dal Pino took over as representative of the Telecom Italia Group in Latin America, reporting directly to the Chairman, and a proposal will be put forth to appoint him as Chairman of Telecom Italia Latam.

### ***Reorganization***

The Telecom Italia Group continued to reorganize its operations during 2003. As a result, the following organizational changes took place:

- the Corporate Development and Investor Relations Function and the International Affairs Function, which now includes the Foreign Holdings Function, were created and report directly to the CEO Carlo Buora;

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- the International Wholesale Services function of the Wireline Business Unit was moved to TMI Italia S.p.A.; which changed its name to Telecom Italia Sparkle S.p.A.;
- the company Telecom Italia Lab S.p.A. was merged with and into Telecom Italia and operates the Research and Development Function for the Telecom Italia Group.

Starting in January 2004, the Telecom Italia Group Committees have been revised as follows:

- **Management Committee** which coordinates the Telecom Italia Group's activities and ensures coordination in the development and implementation of business strategies.
- **Investments Committee** which approves investments exceeding specific levels of approval.
- **Purchases Committee** which promotes coordination of the Telecom Italia Group's purchasing processes, monitoring their performance and maximizing synergies among the Business Units/Companies.
- **Business Reviews** which control the results of each Business Unit, analyze forecasts and operational progress reports and decide on the resulting action plans.
- **Publishing Committee** which establishes strategic guidelines relating to the publishing lines of reference for the Telecom Italia Group. Reporting to the Publishing Committee is the Operating Content Acquisition Committee which purpose is to ensure a whole vision of the initiatives developed by the Business Units, to leverage the contents of the Telecom Italia Group's offerings and packages and to define a synergic approach with suppliers.
- **Technological Committee** which coordinates the innovation and technological development processes.
- **IT Security Committee** which ensures coordination in the management of the information and computer security of the Telecom Italia Group.
- **Latin America Purchases Committee** which promotes coordination of the purchasing processes in Latin America, monitoring their performance and maximizing synergies among the operating companies.
- **Latin America Image Awareness and Advertising Committee** which is responsible for the uniformity of advertising and image awareness initiatives of the Telecom Italia Group in Latin America.
- **Latin America Regional Coordination Committee** which is responsible for the overall consistency of the Telecom Italia Group's activities in Latin America, ensuring coordination in the development and implementation of business strategies.

**Table of Contents****BUSINESS UNITS****Wireline**

The Wireline Business Unit operates on a national level as the consolidated market leader in wireline telephone and data services and call centers, 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. Aggressive competition in the Italian domestic market continued during 2003. Competition was particularly significant for national traffic and Wireline countered with new rate plans offered as part of the action to win back and retain customers.

The Wireline Business Unit accounted for gross operating revenues of 17,216 million in 2003, 17,047 million in 2002 and 17,174 million in 2001. The 2003 results of operations reversed last years trend with positive growth of about 1% in gross operating revenues 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, 2003 was as follows:

<b>Telecom Italia Wireline</b>	<b>National Subsidiaries</b>	<b>International Subsidiaries</b>
Wireline TLC services:	Atesia S.p.A.	Latin American Nautilus Group
	Path.Net S.p.A.	Mediterranean Nautilus Group
• Retail Telephone	Loquendo S.p.A.	Med-1 group
• Internet	Telecontact Center S.p.A.	Telecom Italia Deutschland holding GmbH
• Data Business		HanseNet Telekommunikation GmbH
• Telephone and Data VAS		BBNED Group
• National Wholesale	Telecom Italia Sparkle Group	
	• Telecom Italia Sparkle S.p.A.	
	• Pan European Backbone	
	• Telecom Italia of North America Inc.	
	• Intelcom San Marino S.p.A.	

**Key Issues in Italy**

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- 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 market through ADSL connections offered respectively to the consumer and SOHO (Small Office Home Office) markets with two different branded packages: Alice and Smart .
- This strategy has had significant success in Italy with 2,040,000 broadband points of access sold to the retail and the wholesale market at the end of 2003 (850,000 at December 31, 2002), of which 1,504,000 points of access have been sold to retail customers. The growth is attributable to the success of various tariff structures geared to the mass market (Alice) and to business customers (Smart).
- The Wireline Business Unit is seeking to grow revenues by developing offers for Alice customers through a specialized portal with a growing number of services. During 2003 many new offers were successfully launched on the market, such as ADSL Sat offers to support internet connections through satellite for areas not covered by ADSL connections.

The Wireline Business Unit plans to develop new services, improving innovative use of its fixed network (such as video communications and SMS (Short Message Service) for fixed phones) through penetration with Telecom Italia's new fixed telephone, *Aladino*, with functions and design very close to a mobile last generation phone.

- Another key issue for Wireline is the expansion of its Wi-Fi service which provides the opportunity for customers to work everywhere with their own lap top, keeping in touch with the network (the company intranet, internet and their own private e-mail) with a high speed connection and without the need to connect to a fixed line.



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The service is now available with different formulas (flat and pay per use) in more than 159 hot spots, so called areas where there is an access point with Wi-Fi coverage available.

- 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.

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

	As of December 31,				
	1999	2000	2001	2002	2003
Subscriber fixed-lines at period-end in Italy (thousands)(1)	26,502	27,153	27,353	27,142	26,596
Subscriber fixed-line growth per annum in Italy (%) (2)	2.0	2.5	0.7	(0.8)	(2.0)
ISDN equivalent lines at period-end in Italy (thousands)(3)	3,049	4,584	5,403	5,756	6,027
Broadband Access in Italy (ADSL + XDSL) (thousands)(4)			390	850	2,040
Voice Offers in Italy (thousands)(5)			4,094	5,224	5,547

(1) Data include multiple lines for ISDN and exclude internal lines.

(2) For each of the years ended December 31, the percentage growth figure represents growth per annum over the prior year's end.

(3) Excluding internal lines.

(4) Number of contracts.

(5) Numbers of contracts; data include Teleconomy, Hellò and other business voice offers.

As of December 31, 2003, the Wireline Business Unit had approximately 26.6 million fixed subscriber lines, including approximately 18.3 million residential lines (including multiple lines for ISDN), approximately 8.1 million business lines (including multiple lines for ISDN), and approximately 235,000 public telephones lines (including ISDN equivalent lines). As of December 31, 2003, Italy had 47 subscriber lines per 100 inhabitants.

As of December 31, 2003, the Wireline Business Unit had approximately 6.0 million ISDN equivalent lines. The number of subscribers is expected to continue increasing although marketing focus is on ADSL lines which provide greater speed on the Internet. This is evidenced by significant growth in broadband access.

As of December 31, 2003, 59.3% 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 one public telephone per square kilometer and approximately 4.1 public telephones for every 1,000 inhabitants. During 2003, ISDN technology was introduced to approximately 54.5% of public telephones in order to support the launch of innovative services (approximately 128,000 basic ISDN equivalent lines in public telephony architecture; unlike residential and business ISDN lines, each ISDN public telephone line is linked to only one phone).

**Wireline 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.

Revenues in the retail telephone segment consist mainly of traffic revenues and fee 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.

Revenues from retail telephone (the Wireline segment addressing the retail and mass market) were 10,368 million in 2003, a decrease of 1.7% compared to 2002 ( 10,547 million in 2002). The Wireline Business Unit successfully limited the intense competitive impact in the retail segment during 2003. Traffic packages (voice offers), loyalty and retention schemes and win-back strategies resulted in limited revenue losses while market share on traffic volumes was stable.

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### ***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.

Retail Internet revenues consist primarily of internet dial-up traffic revenues and revenues from access fees for ADSL connections.

During 2003, the Wireline Business Unit focused its efforts on growing its ADSL mass market base and attracting new customers by building an internet portal for Alice customers with a growing offer of services, including, among others videos, pictures and music.

Revenues grew significantly in 2003, to 709 million, an increase of 19.2% over 2002 ( 595 million in 2002). Revenues from ADSL were approximately 257 million increasing strongly by 190% over 2002 ( 89 million in 2002) although revenues from internet dial-up traffic decreased due to migration to internet connections from broadband access.

### ***Data Business***

**Data Services.** Data services consist primarily of data transmission and network services for business customers. Revenues from data services are included primarily in fixed subscription and connection fees.

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).

During 2003, the Wireline Business Unit introduced several innovative offers for the data transmission networks and Internet access, including:

- Wi Fi service: internet wireless and high speed access (available since the end of 2003);
- new solutions with fiber optic technologies for SMEs (small and medium-sized enterprises), mainly for IP services;
- broadband everywhere project: plan to cover 100% of business customers sites with broadband technology.

Revenues from data services (including data equipment rental and assurance) amounted to 1,103 million in 2003 and increased by 12.3% over 2002 ( 982 million in 2002). The growth in revenue from data services has been driven mainly by innovative data services (data transmission through broadband and the fiberoptic technology network) that increased by more than 42% in 2003 compared to 2002 ( 520 million in 2003 and

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366 million in 2002) while revenues from data equipment increased to 246 million (approximately 220 million in 2002).

Revenues from traditional data services (data transmission using data packet technology) decreased from approximately 400 million in 2002 to approximately 340 million in 2003 due to customer migration to broadband services.

**Leased Lines.** 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.

In 2003, revenues from lines leased to business customers were 407 million (461 million in 2002). The decrease in revenues in 2003 compared to 2002 was primarily attributable to the migration by customers towards other kinds of connections which are offered at lower prices. Leased lines have been gradually replaced by broadband connections that offer many advantages such as new services and flexible connection packages; prices are gradually falling for new offers and for migration to higher speed lines that allow more data transmission with lower cost.

As of December 31, 2003, there were approximately 274,000 (in points of entry of data network) lines leased to business customers (approximately 320,000 at December 31, 2002) and approximately 107,000 digital leased lines (132,000 at December 31, 2002).

**Table of Contents****Retail Value Added Services**

Retail VAS include new services for all Wireline customers such as web services, outsourcing and security for business customers and SMS (from fixed telephones), Memotel (centralized mail box) and Chi è (identification of calling number) for residential customers. Revenues from VAS have grown significantly in recent years. In 2003, the Wireline Business Unit VAS revenues were 1,122 million, an increase of 13.3% over 2002 (990 million in 2002) mainly due to an increase in the services offered and the number of new customers.

**Wholesale**

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 3,269 million in 2003, approximately the same amount as the previous year. Domestic wholesale services decreased by approximately 45 million due to price reductions in interconnection services, not completely absorbed by growth in revenues from broadband and other services. International wholesale services increased by approximately 45 million, due to significant growth in traffic volumes, especially in traffic carried to other operators.

**Traffic and Tariffs****Domestic Traffic**

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

	Year ended December 31,				
	1999	2000	2001	2002	2003
Wireline total traffic (Retail and Wholesale) (billions of minutes)	134.8	171.3	209.8	214.9	226.6
<i>of which:</i>					
<i>National(1)</i>	128.1	163.8	201.1	204.7	215.2
<i>International(2)</i>	6.7	7.5	8.7	10.2	11.4
<b>Retail Traffic:</b>					
Average minutes of use per fixed line subscriber during period(3)	4,298	4,722	4,739	4,292	4,127
<i>of which:</i>					
<i>Local traffic during period (in average minutes)(4)</i>	2,767	3,621	3,575	3,198	2,971
<i>Long distance traffic during period (in average minutes)</i>	1,531	1,101	1,164	1,094	1,156

- 
- (1) Data include total retail traffic (international outgoing traffic excluded) and total domestic wholesale traffic.
  - (2) Data include international retail outgoing traffic and total international wholesale traffic.
  - (3) Data include total retail fixed outgoing traffic (including international outgoing traffic and fixed outgoing traffic to mobile networks).
  - (4) Data for the year 1999 include internet dial-up traffic and excludes district traffic which is accounted for in long distance traffic; data for the years 2000, 2001, 2002 and 2003 include district and internet dial-up traffic.

**Domestic Fees and Tariffs.** Since November 1, 1999, the Telecom Italia Group's 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: 0.0619 for local calls, 0.0787 for long distance calls and for fixed-mobile calls of business customers, 0.1200 for fixed-mobile calls of residential customers 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, the Telecom Italia Group has introduced tariff packages for residential and business customers which provide for discounts on national and international traffic tariffs and additional rental charges.

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

Hello was launched as a brand during 2003 while Teleconomy was launched in June 2000. Both of them include tariff packages with targeted discounts and customized programs for residential and business customers. Hello offers were launched to further support retention efforts and to win back customers.

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Penetration of Telephony and Hello offers and ADSL lines are key strategic priorities for the Wireline Business Unit.

Hello offers for retail customers, which Wireline Business Unit introduced in 2003, include:

- Hello Sempre (fixed price of 0.125 for national calls, excluding calls to mobile, at an additional monthly fee of 5.58 euro); and
- Hello Forfait (no payment for national calls, excluding calls to mobile, at an additional monthly fee of 39.0).

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

**Domestic Tariff Rebalancing.** The Telecom Italia Group commenced rebalancing its tariffs in 1991 and made various adjustments until 1997. Since December 1998, the National Regulatory Authority has been responsible for tariff regulation. On July 28, 1999, the National Regulatory Authority 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 National Regulatory Authority. 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 National Regulatory Authority 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 National Regulatory Authority introduced a new price cap mechanism, also referred to as a safeguard cap, which is intended to control the maximum prices Telecom Italia may charge for voice services for the four year period 2003-2006. In 2003 the National Regulatory Authority identified three separate baskets:

- access;
- local and long distance calls; and
- 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.

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The National Regulatory Authority 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:  $RPI + 0\%$ , as well as a sub-price cap for residential subscription charges of  $RPI - RPI$  ( $RPI-RPI=0$ );
- 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  $RPI-6\%$ .



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

Consistent with the new price-cap mechanism, Telecom Italia continued to simplify its pricing structure during the course of 2003. In particular, beginning September 15, 2003, the following price changes became effective:

- access for basic subscription fees and business charges increased by 6.5%;
- local call traffic: the discount on local calls exceeding 15 minutes was eliminated resulting in a price increase of 1.8%; and
- long-distance traffic: the two different pricing levels applied to calls were unified, resulting in one single rate at a point where customer telephone charges were reduced by 3% with the following impacts on the caps:
  - basic subscriber charges and other access charges increased by 2.3%; and
  - local and long distance call charges: 0%.

In addition, on June 1, 2003, the price of Wireline to Mobile traffic was reduced by 11.7% as a result of a reduction in the Termination Charge of 10.9% and the Retention Charge of 14.3%.

In particular:

- the Termination Charge represents the cost that Telecom Italia incurs for terminating the traffic generated by its Wireline customers on the networks of mobile operators; the rate per minute is fixed by the mobile operators; and
- Retention represents the difference between the amount paid by the customer and the amount due to the mobile operators for termination: the rate per minute for Retention by Telecom Italia is fixed by the National Regulatory Authority (Order 47/03 CONS).

With respect to international traffic, after the sharp price reductions in the years 1998-2002, during 2003 a single adjustment was put into place (on November 1) consisting of the introduction of a new rate zone, without causing any change in customers expenditures.

***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,				
	1999	2000	2001	2002	2003
Total outgoing traffic (millions of minutes)	2,390	2,706	3,015	3,405	3,682
Growth in outgoing traffic (%) <sup>(1)</sup>	2.2	13.2	11.4	13.0	8.1
Total incoming traffic (millions of minutes)	3,419	3,415	3,845	3,842	3,299
Growth in incoming traffic (%) <sup>(1)</sup>	15.9	-0.1	12.6	-0.1	-14.1
Total international transit traffic (millions of minutes)	857	1,310	1,825	2,995	4,382
Growth in international transit traffic (%) <sup>(1)</sup>	7.6	52.9	39.3	64.1	46.3

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

The trend in international traffic volumes from 1999 to 2003 was mainly impacted by macroeconomic factors such as growth in foreign demand, import/export activities, foreigners and new subscribers. The decline in gross operating revenues from 2002 to 2003 is mainly attributable to the impact of continuing price reductions and increasing competition.

Outgoing international traffic is mostly concentrated in communications traffic with Germany, France, Romania, Switzerland, United States, United Kingdom, Albania and Spain, which together accounted for approximately 48% of toll minutes in 2003.

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

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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 directed to the mobile network decreased because the component of the traffic deemed to be incoming registered a 93% decline due to the introduction of a surcharge for calls directed to the mobile network with a consequent increase in the price of the international calling cards.

In order to make up for the loss in market share following the decrease in incoming traffic, wholesale international activities were focused on managing international transit traffic that resulted in volume increases of 46% due to the competitiveness of Telecom Italia's offer in the worldwide market.

**International Settlement Arrangements.** The Telecom Italia Group derives revenues from foreign telecommunications operators for incoming calls which use the Telecom Italia Group's network. The Telecom Italia Group has 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, the Telecom Italia Group's net payments on international accounting rates are negligible. This has the effect of limiting the Telecom Italia Group's 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 National Regulatory Authority approved the introduction of the Network Cap mechanism to regulate interconnection tariffs until the end of 2006. The mechanism will govern the amounts Telecom Italia can charge other operators that want to utilize Telecom Italia's network to provide telecommunications services. Starting with the 2003 Reference Offer (RO), the market will have greater transparency with respect to the arrangements relating to interconnection services, allowing the 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 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 (i.e. number portability charges, CPS (Carrier Pre-selection Service) charging, etc.) = RPI - RPI

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- LLU (Local Loop Unbundling) = As of June 1, 2004, the National Regulatory Authority has not defined the caps related to this service.

With respect to LLU, the National Regulatory Authority in its order has 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, Telecom Italia applies an LLU price (of 8.30/month) which is the lowest in Europe and is significantly lower than the Telecom Italia retail access price. Prior to implementing this price, Telecom Italia's LLU price was 10.79 per month for POTS 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 its 510,000 fully unbundled lines on December 31, 2003 (Italy is second after Germany where LLU started about two years before), representing an increase of 407,000 lines compared with the end of 2002. In addition, Telecom Italia presents the most detailed and complete LLU offer in Europe (physical LLU, sub loop unbundling, shared access and all different kinds of co-location) and Telecom Italia has satisfied all National Regulatory Authority requests in terms of equipment of the sites requested by OLOs.

In August 2003, the National Regulatory Authority approved, subject to certain technical and economic amendments, the 2003 RO originally submitted by the Telecom Italia Group in April 2003.

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The Telecom Italia Group's 2003 RO includes the conditions for FRIACO (Flat-Rate Internet Access Call Origination) service, partial circuits provisions, shared access and sub-loop unbundling, thus enabling a competitive development of internet access and broadband services.

- FRIACO: the Telecom Italia Group has been offering this service since 2001.
- Partial circuits: represent partial circuits from customer premises to the OLOs' Point Of Presence ( POP ), as a segment of an end-to-end leased line. The National Regulatory Authority 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 with Order No. 10/00/CIR. 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: the Telecom Italia Group must also offer billing to OLOs who decide not to bill the customers (*i.e.* customers that are connected to the network through indirect access service) accessing their non geographic services. The Telecom Italia Group, as required by the National Regulatory Authority, fixed the level of charge for the billing service at 2.9% calculated on the total revenues of each OLOs non geographic service. With respect to bad debt, the level of risk and insolvency is subject to negotiation between Telecom Italia and the OLOs.

Since April 2002, ISPs (Internet Service Providers) (pursuant to law 59/02) have access to the RO of the notified operators with respect to internet traffic origination (both for metered and unmetered interconnection) and termination on 70x codes (dedicated in Italy to Internet access) and partial circuits. On June 26, 2002 the National Regulatory Authority issued an Order to define the criteria for ISPs to gain access to the RO technical and economic conditions.

On April 28, 2003, the National Regulatory Authority approved rules which discipline the manner in which customers can request deactivation of the Carrier Preselection Service. The National Regulatory Authority determined that a client can send his deactivation request both to Telecom Italia and to the preselected OLO.

In 2003, the Telecom Italia Group set up interconnections with the networks of 8 additional operators, making a total of 92 operators at December 31, 2003. In the same period eight operators have disconnected.

During 2003, the following contracts were also signed or renewed:

- Seven new interconnection agreements (for a total of 91 since 1995);
- Seven additional reverse agreements, terminating calls on the network of another operator, for a total of 71, since 1998;
- 39 agreements to supply high-speed access services using xDSL technology;
- Five carrier preselection contracts, one district carrier selection agreement and 12 number portability agreements;

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- One contract for local loop unbundling service on the local network for a total of 41 since 2000;
- 29 contracts to supply Digital Data Circuits for a total of 112 since 1998.

### **Fixed Network**

Since 1988, the Telecom Italia Group has installed high levels of fiber optics, intelligent nodes, digital switching, satellite connections and high speed data transmission technology. The technologically advanced nature of its fixed network permits the Telecom Italia Group to offer a variety of advanced services such as toll free numbers, call waiting and call forwarding, VPNs (Virtual Private Networks), premium charges and charge splitting.

### *Domestic Network*

**Fixed Network.** The Telecom Italia Group's domestic fixed network is made up of 33 gateway areas (each area gateway has two points of interconnection which allows our fixed and mobile network to exchange signals) and 628 main local switches (only for fixed OLOs). Each local switch belongs to only one of the 33

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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. In detail, the national network in statistics at December 31, 2003 was as follows:

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	428,741 kilometers-line
Fiber optic carrier network	3.2 million kilometers-line
Direct dialing circuits	3.9 million
Network for direct digital circuits (PARD)	474,690 access points with speed up to 2 Mbit/s
Network for direct analog circuits (PARD)	94,043 access points
Frame Relay Accesses	83,824 gates at 2Mbit/s
PoP main data networks	32

**SDH and ATM.** The Telecom Italia Group 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 fibreoptics from 155 Mbit/s up to 2.5 Gbit/s. Moreover, in 2002 Telecom Italia began using transmission systems with speed up to 10 Gbit/s. Work on the development of the Arianna network 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 2003. Arianna is based on a SDH rings architecture; since 2000, 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 Arianna towards the new generation of meshed ASTN (Automatically Switched Transport Network) optical backbone which started during 2003 and will continue during 2004. By using the ASTN approach it is possible to build a multiservice platform with a high level of integration with the IP network. First applications of Metro DWDM systems were developed in the Rome and Milan metropolitan areas.

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 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.** Telecom Italia Group's investment in its domestic service network has enabled it 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.

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To reduce costs and improve efficiency, the Telecom Italia Group undertook in 2001 and continued in 2002 and in 2003 an extensive program to reengineer its network operation and maintenance organization, to permit a more effective use of human resources.

Beginning in 1999, operating systems were developed with the aim of ensuring the offering of new services, optimizing operational activities and pursuing objectives of total quality. 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



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transmission, features were activated which reduce activation and connection time, permit the timely recognition of customers who have experienced malfunctions in services and augment the availability of the connections themselves. Moreover, operating systems have been equipped with new features for marketing new services.

**Broadband Network/ADSL.** The Telecom Italia Group's broadband network is capable of supporting advanced telecommunications services and multimedia applications and, to this end, the Telecom Italia Group has installed significant levels of fiber optic cables in its fixed network. In 1998, the Telecom Italia Group began introducing ADSL systems over copper pairs to deliver interactive services (e.g., fast-Internet). ADSL allows the Telecom Italia Group to fulfill in the short-term, 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 the Telecom Italia Group to focus the commercialization of its broadband network services on a market basis and to tailor investments to the growth of the market. With reference to access services using ADSL technology, in 1999, the technical and commercial trials with fast Internet access for residential and Soho customers, begun in Rome and Milan at the end of 1998, were concluded. In 2003, commercial services with access to ADSL technology for business customers and Internet Service Providers had been extended to 2,100 cities (approximately 1,300 at the end of 2002). The commercial services for business customers include the use of ADSL technology in urban areas to supply access to IP and ATM services of the Telecom Italia Group's 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 2003, the local exchange areas covered by ADSL technology numbered 3,000 (2,120 at the end of 2002).

**Fiber optic Cables.** At December 31, 2003, the Telecom Italia Group had installed approximately 3.64 million kilometers of optical fiber for access and transfers, of which approximately one million kilometers were installed on long distance fixed-lines. Fiber optic cables significantly increase the capacity of the network and permit the Telecom Italia Group 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, the Telecom Italia Group is planning to introduce fiber optics in its local access network.

In 2003, a project which started in the second half of 2000, consisting of the creation of an optical fiber ring between Milan and Palermo (T-Bone), was continued with the installation of cable containing 96 optical fibers on two backbones covering about 6,000 kilometers.

**Flexible Data Network.** The Telecom Italia Group also operates a flexible network equipped with a centralized system that makes it possible to establish dedicated data links from a work station. At December 31, 2003, 500,000 direct digital line access points and 100,000 direct analog line access points had been installed.

## ***International Network***

Since 1997, the Telecom Italia Group has rationalized its international fixed network and enhanced international transmission capacity.

The Telecom Italia Group offers international wholesale services (Voice, Data and IP) and international retail services (Global Corporate Network) for multinational customers utilizing its own cross-border backbone, bilateral links and NNI Agreements (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., Netherlands, 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 earth and under sea, 30,000 km long, 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;

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- **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.

Telecom Italia Group, with its international network, connects more than 250 world-wide operators and owns capacity on more than 434,500 kilometers of submarine cables that, from Italy, transport traffic along two major paths: longitudinal routes (towards the United States, Middle and Far East) and diagonal routes (toward Central and North Europe).

The multiservice network is based on class-4 softswitch, that are substituted for traditional exchanges, 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).

Telecom Italia Group's international backbone has been built to offer end-to-end services in strategic areas; it has Points of Presence in Europe (16 POPs), in USA (3 POPs), in the Mediterranean basin (4 POPs) and in South America (7 POPs).

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

The multiservice backbone delivers voice, IP and managed bandwidth services in the USA and Europe and managed bandwidth services in the Mediterranean and in South America where, from 2003, IP services have been added.

During 2003, there were major implementations related to cross-border backbone deployments in Europe, the Mediterranean and Latin America. In particular, the main activities in Europe have been to widen the IP and data services portfolio:

- PanEuropean Backbone extension in Spain with two new POPs (Madrid and Barcelona);
- deployment of optical city rings in London, Paris, Frankfurt, Amsterdam, Zurich and Vienna, with points of presence in the main European telehouse facilities. A telehouse or co-location center (colo) is a type of data center where multiple telecommunications network or service providers, such as telecommunication operations or ISPs, site their connections to other networks;
- new POPs in Lyon and Marseille, also to support ADSL services in France;
- upgrading of access and switching devices to support wholesale Fast Ethernet, Giga Ethernet, IP Burstable, ToIP services and retail services for Multinational Customers.

In addition we have upgraded transmission capacity of the Pan European and transatlantic backbone.

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Finally, in order to improve quality of service and decrease operational costs, a project was begun to replace the Italian legacy switching exchanges with the class-4 softswitch now used in the Telecom Italia Group's backbone (Europe and USA).

### ***Retail International Network***

During 2003, Telecom Italia started the European project International Broadband through:

- the start-up of Telecom Italia France, a new licensed French operator;
- the acquisition of HanseNet, an existing German operator active in the Hamburg area.

Telecom Italia intends to offer access to innovative broadband services in the main European metropolitan areas, leveraging on its know-how and technological assets, beginning with France and Germany.

**France.** In 2003, Telecom Italia France was organized, a start-up company that will offer services mainly based on Local Loop Unbundling.

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The main activities carried out during 2003 have been:

- deployment of POPs in the cities of Paris (2 POPs), Lyon, Marseille (also serving Aix-en-Provence) and Nice;
- 116 central offices equipped for local loop unbundling;
- deployment of fiber optic connections among POPs, through Telecom Italia's Pan European Backbone, and between POPs and 106 exchanges for a total of 1,210 Km. The remaining exchanges are connected to the POPs through leased lines;
- creation of interconnectivity with France Telecom for voice and data traffic.

**Germany.** In September 2003 we acquired HanseNet, a city carrier with its own infrastructure, with the goal of developing broadband services in the Hamburg area. Technical platform enhancement, to support services starting in 2004, was activated.

The main features of Hansenet network as of December 31, 2003 were:

- 3 POPs;
- 100 local exchange for the unbundling service;
- 1,090 Km fiber optical cables;
- 420 interconnection circuits with Deutsche Telecom (2Mbit/s).

*Financial data of the main subsidiaries*

The following table sets forth operating revenues, gross operating profit and operating income for the main subsidiaries of the Wireline Business Unit on a stand alone basis. The financial data will not tie directly to consolidated segment data due to intercompany, consolidation and other adjustments.

National Subsidiaries				International Subsidiaries			
Atesia	Path.Net	Loquendo	Telecom	HanseNet	Latin	Mediterranean	Med-1 Group
			Italia	Telekom- munikation	American	Nautilus Group	
			Sparkle				

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					<u>Group</u>	<u>GmbH</u>	<u>Nautilus</u>					
					(*)		Group					
									U.S.\$	U.S.\$	U.S.\$	
Gross operating revenues	2003	93	117	15	1,671	102	40	46	63	71	17	20
		98	93	15	19	83	29	28	64	61	20	19
	2002	(5.1)	25.8			22.9		64.3		16.4		5.3
	Change (%)											
Gross operating profit	2003	26	10	1	296	18	4	5	22	25	11	12
		38	5	0	(30)	22	11	11	26	24	12	12
	2002	(31.6)	100.0			(18.2)		(54.5)		4.2		
	Change (%)											
Operating income	2003											
	2002	17	9	(2)	144	(24)						
	32	4	(1)	(43)	(37)	(13)						
	Change (%)	(46.9)	125.0	(100.0)		35.1	(6)					