

TELECOM ITALIA S P A
Form 20-F
May 27, 2005
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 20-F

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

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: December 31, 2004

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

Telecom Italia S.p.A.

(Exact name of Registrant as specified in its charter)

Italy

(Jurisdiction of incorporation or organization)

Piazza degli Affari 2, 20123 Milan, Italy

(Address of principal executive offices)

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

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

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

None

(Title of Class)

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

None

(Title of Class)

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

Not applicable

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

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.

Beginning with the first quarter ended March 31, 2005, we will report our financial information and prepare our financial information and our financial statements in accordance with International Financial Reporting Standards (IFRS). See Item 3. Key Information 3.1 Risk Factors In 2005 we are obliged to adopt IFRS which will impact our financial results and results of operations as they differ in significant respects from Italian GAAP , and Item 5. Operating and Financial Review and Prospects 5.4 Critical Accounting Policies and 5.5 Adoption of International Accounting Standards .

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 for the period 2005-2007 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 3.1 Risk Factors , (ii) Item 4. Information on the Telecom Italia Group 4.1 Business 4.1.3 Significant Developments During 2004 and 4.1.8 Updated Targets and Strategy , (iii) Item 4. Information on the Telecom Italia Group 4.3 Regulation , (iv) Item 5. Operating and Financial Review and Prospects , (v) Item 8. Financial Information 8.3 Legal Proceedings and (vi) Item 11. Quantitative and Qualitative Disclosures About Market Risks , including statements regarding the likely effect of matters discussed therein. Actual results may differ materially from those projected or implied in the forward-looking statements. Such forward-looking information involves risks and uncertainties, which are outside our control, that could significantly affect expected results and are based on certain key assumptions.

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

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

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Introduction

- 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 and the TIM Acquisition (each as defined below);
- the impact of the economic recovery in Latin American and economic development generally on our international business and on our foreign investments and capital expenditures;
- the continuing impact of rapid or disruptive changes in technologies;
- the impact of political and economic developments in Italy and other countries in which we operate;
- the impact of fluctuations in currency exchange and interest rates;
- our ability to successfully implement our strategy over the 2005-2007 period;
- our ability to successfully achieve our debt reduction targets;
- our ability to successfully roll out our UMTS network and services and to realize the benefits of investment in our UMTS license 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

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release publicly the result of any revisions to these forward-looking statements which may be made to reflect events or circumstances after the date hereof, including, without limitation, changes in our business or acquisition strategy or planned capital expenditures, or to reflect the occurrence of unanticipated events. See Item 3. Key Information 3.1 Risk Factors and the related cautionary statement under Item 5. Operating and Financial Review and Prospects .

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Key Definitions

KEY DEFINITIONS

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

Telecom Italia	means the entity which resulted from the Merger.
Telecom Italia Group	means the Company and its consolidated subsidiaries.
Old Telecom Italia and Old Telecom Italia Group	means Telecom Italia and its consolidated subsidiaries as they existed immediately prior to the effective date of the Merger.
Olivetti	means Olivetti S.p.A., the holding company and controlling shareholder of Old Telecom Italia.
Olivetti Group	means Olivetti and its consolidated subsidiaries, including Old Telecom Italia.
Merger	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.
Shares	means the ordinary shares, 0.55 par value each, of Telecom Italia.
Savings Shares	means the savings shares, 0.55 par value each, of Telecom Italia.
TIM	means Telecom Italia Mobile S.p.A. and following the spin-off of the domestic mobile assets which is part of the TIM Acquisition, TIM Italia S.p.A., the Telecom Italia Group's subsidiary operating in the mobile telecommunications business.
TIM Acquisition	means the acquisition by Telecom Italia of the ordinary shares and savings shares of TIM it does not already own through a cash tender offer completed on January 21, 2005 to be followed by a merger of TIM S.p.A. with and into Telecom Italia, expected to be completed by the end of June, 2005.
Telecom Italia Media	means the corporate name of the remaining part of Seat Pagine Gialle S.p.A. which resulted from the proportional spin-off of the directories and most of the directory assistance and business information business segments of SEAT into New SEAT. The spin-off became effective on August 1, 2003 and new SEAT was disposed of on August 8, 2003. Telecom Italia Media is the Telecom Italia Group's subsidiary operating the Internet & Media business.
EU	means the European Union.

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Item 1. Identity of Directors, Senior Management and Advisers

Item 2. Offer Statistics and Expected Timetable

Risk Factors

Item 3. Key Information

PART I

Item 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not Applicable

Item 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not Applicable

Item 3. KEY INFORMATION

3.1 RISK FACTORS

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

Strong domestic competition exists in all of the principal telecommunications business areas in Italy in which we operate, including, most significantly, 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, 2004, there were a number of significant competitors offering fixed-line services and three other operators (besides TIM) 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 and maintained our market share in 2004, continuing pressures on prices due to competition and further erosion in market shares could adversely affect our results of operations. Continuing changes to the regulatory regime, including carrier preselection, number portability and local loop unbundling as well as the implementation of new EU telecommunications directives and the continuing entry of strong international operators in our markets are increasing 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 businesses to increase traffic on our networks and find alternative 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. These strategic initiatives have required and will continue to require substantial expenditures and commitment of human resources. Although these initiatives are core to our strategy, we may be unable to introduce commercially these new products and services, and even if we introduce them, there can be no assurance they will be successful.

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Item 3. Key Information

Risk Factors

Our business will be adversely affected if we are unable to successfully implement our business plans, particularly in light of the Merger and the TIM Acquisition. 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;
- Improve cost efficiency; and
- Strengthen the financial structure.

The most significant objectives of the Industrial Plan were achieved, 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 order to satisfy a series of business needs, prompted by the progressive convergence between fixed and mobile platforms, Telecom Italia decided to make the TIM Acquisition. The strategic and industrial objectives of the TIM Acquisition are to:

- simplify the chain of ownership of the group;
- unify management of the fixed and mobile businesses to improve business opportunities;
- realize significant synergies from the integrated management of fixed and mobile telecommunications in Italy and abroad; and
- optimize financial and cash flows within the Telecom Italia Group by managing our debt more efficiently, making better use of financial leverage and reducing our weighted average cost of capital.

In connection with the Merger and the TIM Acquisition, we confirmed the objectives and guidelines of the Industrial Plan and established certain targets for the 2005-2007 period, which include strict capital expenditures and cost controls and instituting other actions to ensure the reduction of the debt level we have as a result of the Merger and the TIM Acquisition. See Item 3. Key Information 3.1 Risk Factors As a result of the Merger and the TIM Acquisition we remain highly leveraged .

Factors beyond our control that could affect the implementation and achievement of the strategic objectives of the TIM Acquisition and reaching our targets for the period 2005-2007 include:

- our ability to manage costs;
- our ability to attract and retain highly-skilled and qualified personnel;
- our ability to effectively integrate the Telecom Italia and TIM organizations;
- our ability to achieve the synergies anticipated from the TIM Acquisition;
- 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;
- our ability to divest additional non-core businesses and the adequacy of the returns of such divestitures;
- 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:

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

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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, and, if we continue to be identified as having significant market power in all relevant markets, will be, subject to a number of regulatory constraints, including:

- a requirement to conduct our business in a transparent and non-discriminatory fashion;
- a requirement to have our prices for fixed voice telephony services and Reference Interconnection Offer, the tariff charged to other operators to utilize our network, subject respectively to a price cap and a network cap mechanism. This cap mechanism places certain limits on our ability to change our prices for certain services; and
- a requirement to provide interconnection services, leased lines and access to the local loop to other operators at cost-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 to directly access customers connected to the network by leasing the necessary components from us.

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. Included within this new framework is the obligation on the part of the National Regulatory Authority to identify operators with significant market power based on a market analysis in eighteen separate retail and wholesale markets, in which it is considered necessary to intervene to protect free competition. The National Regulatory Authority is currently conducting its analysis. The new framework establishes criteria and procedures for identifying remedies applicable to operators with significant market power. The conclusion of this analysis and the implementation of these revised telecommunications regulations and possible future decisions relating thereto, which is expected to be completed before the second half of 2005, may change the regulatory environment in a manner adverse to us, particularly as they relate to new services which may not currently be part of the eighteen identified markets. Please see Item 4. Information on the Telecom Italia Group 4.3 Regulation in this report for more information on the regulatory requirements to which we are subject.

We 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 and in our other selected international investments due to the competitive environment in these markets.

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

- consolidating our international presence in Latin America, Europe and the Mediterranean Basin;
- developing our international investments in high-growth market segments, such as wireless, data and Internet (broadband);
- strengthening our role 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 (Mobilkom Austria), Telekom Austria,

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9Telecom group and Auna. Consistent with our strategy to focus our Latin American operations principally in Brazil, we recently disposed of Entel Chile (Chile) and intend to sell our interest in Corporacion Digitel (Venezuela) and we will continue to seek to divest certain international non-strategic assets. In April 2005, we entered into an agreement to sell our stake in TIM Hellas, our Greek mobile telecommunications operator. 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 2002, and to a lesser degree in 2003 and 2004. We will continue to target our international investments in Latin America, particularly mobile telecommunications in Brazil, European broadband and mobile telecommunications in selected markets. These investments will continue to require significant capital expenditures and there can be no assurance that we will be able to achieve a satisfactory return on our investments or that we will not suffer further losses and write-downs in markets where we have decided to focus our investments.

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

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

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

Our business is dependent on general economic conditions in Italy, including levels of interest rates, inflation and taxes. A significant deterioration in these conditions could adversely affect our business and results of operations. We may also be adversely affected by political and economic developments in other countries where we have made significant investments in telecommunications operators. Some of these countries have political, economic and legal systems that are unpredictable. Political or economic upheaval or changes in laws or their application in these countries may harm the operations of the companies in which we have invested and impair the value of these investments. 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. In particular, in 2004 the strengthening of the euro against the local currencies in Latin America adversely affected the revenues of the Mobile Business Unit by 150 million.

Our total gross financial debt at year end 2004 was 38,844 million (41,465 million at year end 2003). On January 28, 2005, in connection with the Cash Tender Offer for TIM ordinary and savings shares as part of the

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TIM Acquisition, we borrowed an additional 11.3 billion under a 12 billion Term Loan Facility, granted by a pool of Italian and international banks (0.7 billion of the Tranche A was partially cancelled at the time of drawdown). On February 11, 2005, the remaining 2.3 billion of Tranche A was repaid in advance and cancelled, leaving 9 billion outstanding under the Term Loan Facility. Interest on this debt is calculated by applying an average spread over Euribor of 0.55 basis points. As a result, our total interest payable will increase in 2005 compared to 2004 and our exposure of total debt subject to floating interest rates has increased as well.

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 our UMTS license and related capital expenditures.

Through TIM, we have acquired a third generation mobile telephone, or UMTS, license to commence operations of UMTS services in Italy. 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. 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. We have made investments, although required under our license, which may not be commercially desirable. In addition, there are a number of significant competitors in Italy offering these services including one competitor only offering third generation services, which competitor entered the market prior to our third generation services being available.

We have made significant investments, in accordance with the terms and conditions of our license, to create the infrastructure to offer UMTS services. TIM commenced offering UMTS services in Italy in the second half of 2004 and it is not yet possible to assess the response of the market. 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 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 109% (due to many subscribers having more than one line). TIM's domestic market share declined in 2004 from approximately 46% in the past two years to 42% at the end of 2004. As a result, revenue growth is no longer driven by the rapid subscriber growth which TIM experienced in the 1998-2001 period. Offsetting this decline has been growth in international markets, particularly Brazil, but these markets on the whole are not yet profitable.

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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;
- competitive pressures and regulations applicable to retail and wholesale prices;
- the development and introduction of new and alternative technologies for mobile telecommunications products and services and 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.

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

In recent years the market for telecom stocks and credit ratings of market participants, as well as our ongoing review and refinement of our business plan, resulted in substantial impairment write-downs of our assets (in particular goodwill) which materially adversely affected our results of operations in 2001 and 2002. Although the negative impact of write-downs in 2003 and 2004 was much lower than 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.

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 content and services to consumers and small and medium-sized companies. Our ability to successfully implement this strategy may be affected if:

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

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

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

As a result of the Merger and the TIM Acquisition we remain highly leveraged.

Under Italian GAAP, our gross financial debt was 38,844 million at December 31, 2004 compared with 41,465 million at December 31, 2003, and our total net financial debt was 29,525 million as of December 31, 2004 compared with 33,346 million at December 31, 2003. See Item 3. Key Information 3.3 Selected Financial and Statistical Information Note 9 which reconciles our net financial debt to our gross financial debt.

At December 31, 2004, our gross and net financial debt did not include debt incurred for the TIM Acquisition. As a result of the total outlay borne by Telecom Italia for the purchase of TIM shares tendered and accepted in the Public Tender Offer, we have incurred additional debt of 9 billion and, after taking into account certain cash payments (2.5 billion for the Public Tender offers and 2.3 billion used to repay a portion of the Term Loan Facility), net financial debt would have increased by 13.8 billion. As a result of the tender offer and related transactions, our pro forma gross financial debt and pro forma net financial debt at December 31, 2004 would have been 47.8 billion and 43.3 billion, respectively. Under IFRS net financial debt would increase a further 3.3 billion. We are targeting reducing our net financial debt through:

- significant cash flow generation by our core businesses, and
- net proceeds from disposals used to reduce outstanding debt.

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 generate cash to reduce debt or to refinance existing debt through further borrowing.

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.

Table of Contents**Item 3. Key Information****Risk Factors*****Actual or perceived health risks or other problems relating to mobile handsets or transmission masts could lead to litigation or decreased mobile communications usage.***

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

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

In 2005 we are obliged to adopt IFRS which will impact our financial results and results of operations as they differ in significant respects from Italian GAAP.

Until 2004, we prepared our consolidated financial statements in accordance with Italian GAAP. In June 2002, the Council of Ministers and the Parliament 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 our consolidated financial statements prepared in accordance with IFRS will differ from our consolidated 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 5.5 Adoption of International Accounting Standards for a more complete description of the impact of IFRS reporting on our consolidated financial statements.

Risks associated with Telecom Italia's ownership chain.

Although, as a result of the Merger, no shareholder controlled Telecom Italia, because of the *voto di lista* system for the election of directors, currently 15 out of 21 of our directors (of whom, however, 11 are considered independent) were elected from a slate of candidates proposed by Olimpia, which is currently the largest shareholder in Telecom Italia. As a result of a series of transactions entered into by Olimpia, as of the date hereof, Olimpia holds 21.4% of the Telecom Italia shares. Upon completion of the merger in connection with the TIM Acquisition, and based on the exchange ratio established for the merger of TIM into Telecom Italia, it is estimated that Olimpia's stake in Telecom Italia will be diluted back to approximately 18% on completion of the merger of TIM into Telecom Italia. See Item 7. Major Shareholders and Related-Party Transactions 7.1 Major Shareholders 7.1.1 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 57.66% 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 6.1 Directors 6.1.1 Biographical Data .

Although Olimpia does not and will 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.

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Risk Factors

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 ad hoc rules 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 7.1 Major Shareholders 7.1.3 Continuing Relationship with the Italian Treasury .

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

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

For convenience only (except where noted otherwise), certain euro figures have been translated into dollars at the rate (the **Euro/Dollar Exchange Rate**) of 1.00= U.S.\$ 1.3538, using the noon buying rate in The City of New York for cable transfers in foreign currencies as announced by the Federal Reserve Bank of New York for customs purposes (the **Noon Buying Rate**) on December 31, 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 2000 to 2004 and for the beginning of 2005 certain information regarding the Noon Buying Rate for Dollars expressed in U.S.\$ per 1.00.

Calendar Period	High	Low	Average(1)	At Period End
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	1.3625	1.1801	1.2438	1.3538
2005 (through May 23, 2005)	1.3476	1.2630	1.3039	1.2630
Monthly Amounts				
December 2004	1.3625	1.1801	1.2438	1.3538
January 2005	1.3476	1.2954	1.3123	1.3049

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February 2005	1.3274	1.2773	1.3013	1.3274
March 2005	1.3465	1.2877	1.3185	1.2969
April 2005	1.3093	1.2819	1.2943	1.2919
May 2005 (through May 23, 2005)	1.2936	1.2553	1.2751	1.2575

(1) Average of the rates for the last business day of each month in the relevant period except for May 2005 for which the date used is May 23, 2005.

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. 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 10.5 Description of American Depositary Receipts .

On completion of the Merger, Telecom Italia (formerly Olivetti) became a successor registrant to Old Telecom Italia under the Securities Exchange Act of 1934, as amended (the 1934 Act) and, therefore, became subject to and continues to file periodic reports under the 1934 Act required for a foreign private issuer. Telecom Italia (formerly Olivetti) obtained a listing of the 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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Item 3. Key Information

Selected Financial And Statistical Information

3.3 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 each of the years ended December 31, 2003 and 2004 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; and
- the Telecom Italia Group's selected financial data as of and for each of the years ended December 31, 2002, 2001 and 2000 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) and PricewaterhouseCoopers S.p.A. (for the year ended December 31, 2000).

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.

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

	Year ended December 31,						
	2000		2001(1)	2002(1)	2003(1)	2004(1)	2004
2000(1)	pro forma (Unaudited) (1)(2)						
	(millions of Euro, except per share amounts)						(millions of U.S. dollars, except per share amounts)(3)
Statement of Operations Data in accordance with Italian GAAP:							
Operating revenues	30,116	28,374	32,016	31,408	30,850	31,237	42,289
Other income	483	459	476	504	345	315	426
Total revenues	30,599	28,833	32,492	31,912	31,195	31,552	42,715
Cost of materials	3,058	2,931	2,640	2,315	2,081	2,414	3,268
Salaries and social security contributions	5,245	4,965	4,919	4,737	4,303	4,045	5,476
Depreciation and amortization(4)	6,946	6,509	7,612	7,227	6,779	6,646	8,997
Other external charges	11,136	10,476	12,687	12,188	11,934	12,014	16,265
Changes in inventories	(318)	(296)	92	62	114	(25)	(34)
Capitalized internal construction costs	(912)	(831)	(583)	(675)	(805)	(742)	(1,005)
Total operating expenses(4)	25,155	23,754	27,367	25,854	24,406	24,352	32,967
Operating income(4)	5,444	5,079	5,125	6,058	6,789	7,200	9,748
Financial income	1,202	1,162	1,446	1,569	992	1,381	1,870
Financial expense(4)	(3,857)	(3,648)	(6,559)	(4,647)	(3,256)	(3,215)	(4,353)
<i>Of which write-downs and equity in affiliated and other companies, net</i>	<i>(1,037)</i>	<i>(1,025)</i>	<i>(1,771)</i>	<i>(487)</i>	<i>(91)</i>	<i>(30)</i>	<i>(42)</i>
Other income and (expense), net	135	165	(3,109)	(5,496)	(1,083)	(410)	(555)
Income (loss) before income taxes and minority interests	2,924	2,758	(3,097)	(2,516)	3,442	4,956	6,710
Income taxes	(1,923)	(1,813)	(579)	2,210	(1,014)	(3,054)	(4,135)
Net income (loss) before minority interests	1,001	945	(3,676)	(306)	2,428	1,902	2,575
Minority interests	(1,941)	(1,885)	586	(467)	(1,236)	(1,121)	(1,518)
Net income (loss)	(940)	(940)	(3,090)	(773)	1,192	781	1,057
Net income (loss) per Share(5)	(0.20)	(0.20)	(0.36)	(0.09)	0.07	0.04	0.054
Dividends per Share	0.0350	0.0350			0.1041	0.1093(6)	0.1480
Dividends per Savings Share					0.1151	0.1203(6)	0.1629

Amounts in accordance with U.S. GAAP:

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Total revenues	29,201	29,191	29,467	30,593	41,417
Operating income	3,538	7,181	8,034	7,006	9,485
Net income (loss) before minority interests, discontinued operations and cumulative effect of accounting changes	(2,994)	6,341	3,190	2,801	3,792
Minority interests	18	(3,016)	(1,523)	(1,205)	(1,631)
Net income (loss) from discontinued operations	(1,050)	(1,369)	195	(55)	(74)
Cumulative effect of accounting changes, net of tax	20		(21)		
Net income (loss)	(4,006)	1,956	1,841	1,541	2,086
Net income (loss) per Share before discontinued operations and cumulative effect of accounting changes Basic	(0.87)	0.82	0.18	0.10	0.14
Net income (loss) per Share before discontinued operations and cumulative effect of accounting changes Diluted	(0.87)	0.82	0.18	0.10	0.14
Net income (loss) per Share from discontinued operations Basic	(0.31)	(0.34)	0.02	(0.01)	(0.01)
Net income (loss) per Share from discontinued operations Diluted	(0.31)	(0.34)	0.02	(0.01)	(0.01)
Net income (loss) per Share from cumulative effect of accounting changes Basic	0.01	0.00	(0.01)	(0.00)	(0.00)
Net income (loss) per Share from cumulative effect of accounting changes Diluted	0.01	0.00	(0.01)	(0.00)	(0.00)
Net income (loss) per Share Basic(7)	(1.17)	0.48	0.20	0.09	0.12
Net income (loss) per Share Diluted(7)	(1.17)	0.48	0.20	0.09	0.12

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	As of December 31,						
	2000						
	2000(1)	pro forma (Unaudited) (1)(2)	2001(1)	2002(1)	2003(1)	2004(1)	2004
	(millions of Euro)						(millions of U.S. dollars)(3)
Balance Sheet Data in accordance with Italian GAAP:							
Total current assets(4)	21,097	20,957	23,417	22,597	22,429	21,980	29,757
Tangible assets, net	23,776	21,072	22,097	19,449	18,324	17,717	23,985
Intangible assets, net(4)	39,528	39,062	39,045	34,412	33,853	32,874	44,505
Total assets	95,360	91,832	94,227	83,384	80,501	76,609	103,713
Short-term debt	16,927	16,536	9,072	6,827	10,613	2,027	2,744
Total current liabilities	30,179	29,207	22,984	20,385	23,373	14,650	19,833
Long-term debt	27,485	25,950	37,747	33,804	30,852	36,817	49,843
Total liabilities	63,994	61,304	67,874	62,760	59,912	56,748	76,825
Total stockholders equity before minority interests	13,856	13,856	12,729	11,640	16,092	15,172	20,540
Total stockholders equity	31,366	30,528	26,353	20,624	20,589	19,861	26,888
Amounts in accordance with U.S. GAAP:							
Total current assets			32,449	27,262	21,837	24,885	33,689
Tangible assets, net			23,924	21,241	21,461	20,780	28,132
Intangible assets, net			37,752	36,808	58,413	58,385	79,042
Total assets			104,456	93,893	108,233	107,544	145,593
Total current liabilities			26,075	21,310	23,617	17,610	23,840
Long-term debt			41,865	37,684	32,418	39,257	53,146
Total liabilities			77,304	69,296	68,086	67,789	91,773
Stockholders equity(8)			13,612	15,224	35,067	34,827	47,149
As of December 31,							
2000							
	2000(1)	pro forma (Unaudited) (1)(2)	2001(1)	2002(1)	2003(1)	2004(1)	
Financial Ratios in accordance with Italian GAAP:							
Operating income/operating revenues (ROS) (%)	18.1	17.9	16.0	19.3	22.0	23.0	
Net debt/Net invested capital (debt ratio)(%)(9)	54.5	53.9	59.3	61.8	61.8	59.8	
Ratio of Earnings to fixed charges(10)	2.76	2.87	0.58	0.21	2.55	3.39	
Financial Ratios in accordance with U.S. GAAP:							
Ratio of Earnings to fixed charges(10)			0.68	2.16	3.03	3.63	
Employees:							
Group s employees (at period-end)	120,973	113,475	116,020	106,620	93,187	91,365	
Group s employees (average number)	131,266	123,994	113,974	107,079	95,804	88,892	

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Operating revenues/Group s employees (average number) (thousands)	229.40	228.8	280.9	293.3	322.0	351.4
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Statistical Data:

Wireline:

Subscriber fixed lines in Italy (thousands)(11)	27,153	27,153	27,353	27,142	26,596	25,957
ISDN equivalent lines in Italy (thousands)(12)	4,584	4,584	5,403	5,756	6,027	5,805
Broadband Access in Italy and abroad (ADSL + XDSL) (thousands)(13)			390	850	2,200	4,430
Voice Offers in Italy (thousands)(14)			4,094	5,224	5,547	5,883

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	As of December 31,					
	2000					
	2000(1)	pro forma (Unaudited) (1)(2)	2001(1)	2002(1)	2003(1)	2004(1)
Network infrastructure in Italy:						
access network in copper (millions of km pair)	104.0	104.0	104.3	104.3	105.2	105.2
access network and transport in fiber optics (millions of km of fiber optics)	3.1	3.1	3.2	3.6	3.6	3.7
Network infrastructure abroad:						
European backbone (km of fiber optics)	36,600	36,600	36,600	36,600	39,500	39,500
Mobile:						
TIM lines in Italy (thousands)(15)	21,601	21,601	23,946	25,302	26,076	26,259
TIM group foreign lines (thousands)(16)	7,637	7,637	10,923	13,809	18,438	27,563
TIM group lines total (Italy + foreign in thousands)(16)	29,238	29,238	34,869	39,111	44,514	53,822
GSM penetration in Italy (% of population)	99.6	99.6	99.7	99.8	99.8	99.8
Internet and Media:						
Page views Virgilio (millions)	2,218	2,218	3,945	5,267	6,612	7,902
Active User ISP (thousands)	1,656	1,656	1,804	2,227	2,514	3,346
La7 average audience share (%)	2.0	2.0	2.0	1.8	2.2	2.4
La7 audience share (month of December) (%)	1.9	1.9	1.8	2.1	2.2	2.6

- (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 using 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.
- (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) For the convenience of the reader, Euro amounts for 2004 have been converted into U.S. dollars using the Euro/Dollar Exchange Rate in effect on December 31, 2004 of 1.00 = U.S.\$1.3538.
- (4) Beginning in 2003, Telecom Italia changed the manner in which it accounts for bond issuance expenses by 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.
- (5) 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..

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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. (now Telecom Italia Finance 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. 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;

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- *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 .

Net income per Share in 2004 is calculated on the basis of 16,016,713,271 shares outstanding, of which 10,220,792,202 Shares and 5,795,921,069 Savings Shares; the 10,220,792,202 Shares outstanding are net of 101,208,867 Shares of treasury stock already held by the Company and its subsidiary Telecom Italia Finance S.A. resulting from the redistribution of the share capital in connection with the Merger. In connection with the TIM Acquisition, Telecom Italia will issue 2,116,054,616 new Shares and 242,150,245 new Savings Shares. See Item 8. Financial Information 8.2 Unaudited Condensed Consolidated Pro Forma Financial Data .

For more details on changes in stockholders' equity for the years ended December 31, 2002, 2003 and 2004, respectively, please see page F-6, Telecom Italia S.p.A. Statements of Consolidated Stockholders' Equity for the Years Ended December 31, 2002, 2003 and 2004 of our Consolidated Financial Statements included elsewhere herein.

The per share 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 in addition to dividends paid on the Shares; until July 2000 the par value of ordinary, savings and preferred shares was Lire 1,000 per share. The Extraordinary Shareholders' Meeting of Telecom Italia (formerly Olivetti S.p.A.) held on July 4, 2000 approved the 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 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 Telecom Italia share capital consists of Shares and Savings Shares. Net income per Savings Share was 0.08 in 2003 and 0.05 in 2004.

- (6) Telecom Italia's dividend coupons for the year ended December 31, 2004, were clipped on April 18, 2005, and such dividends for the year ended December 31, 2004 were payable from April 21, 2005.
- (7) 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. 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 and 10,208,294,477 and 5,795,921,069 for the year ended December 31, 2004. The calculations take into account the requirement that holders of Savings Shares are entitled to an additional dividend equal to 2% of the par value of Savings Shares in addition to dividends paid on the Shares. The calculations also take into account that in 2001 and 2002 (after the redenomination of the share capital into Euro following the resolution taken by the Extraordinary Shareholders' Meeting held on July 4, 2000) the par value of 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 and 0.10 in 2004. See Item 8. Financial Information 8.2 Unaudited Condensed Consolidated Pro Forma Financial Data .

- (8) Stockholders' equity under U.S. GAAP is calculated after elimination of minority interests. See Note 27 of Notes to Consolidated Financial Statements included elsewhere herein.

(9)

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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 and 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 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. Telecom Italia management also monitors 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:

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	As of December 31,						
	2000	2000 pro forma (Unaudited)	2001	2002	2003	2004	2004
	(millions of Euro)						(millions of U.S. dollars)(3)
Short-term debt, including current portion of long-term debt	16,927	16,536	9,072	6,827	10,613	2,027	2,744
Long-term debt	27,485	25,950	37,747	33,804	30,852	36,817	49,843
Gross debt	44,412	42,486	46,819	40,631	41,465	38,844	52,587
Cash and cash equivalents:							
• Bank and postal accounts	(2,763)	(2,745)	(3,626)	(4,363)	(4,870)	(8,558)	(11,586)
• Cash and valuables on hand	(8)	(7)	(76)	(7)	(7)	(4)	(5)
• Receivables for securities held under reverse repurchase agreements	(1)	(1)	(4)	(56)	(60)	(2)	(3)
Marketable securities(*)	(2,909)	(2,759)	(3,616)	(1,927)	(2,719)	(932)	(1,262)
Financial accounts receivable (included under Receivables and Other current assets)	(1,210)	(1,210)	(894)	(995)	(826)	(382)	(517)
Financial prepaid expense/deferred income, net and accrued financial income/expense, net (long-term)	(328)	(328)	(705)	(511)	(307)	(282)	(382)
Financial prepaid expense/deferred income, net and accrued financial income/expense, net (short-term)	331	292	464	627	670	841	1,139
Net Financial Debt	37,524	35,728	38,362	33,399	33,346	29,525	39,971

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

Our gross debt and net financial debt has increased significantly as a result of the TIM Acquisition. See Item 8. Financial Information 8.2 Unaudited Condensed Consolidated Pro Forma Financial Data .

(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;
- 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 1,034 million.

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

(12) Data exclude internal lines.

(13) Number of contracts. Broadband access contracts in Italy as of December 31, 2001, 2002, 2003 and 2004 were 390,000, 850,000, 2,040,000 and 4,010,000, respectively.

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

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

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- (16) The foreign lines include those of mobile affiliate AVEA I.H.A.S. (Aria-Is TIM for 2003) and those of T-Mobile CZ. The number of foreign lines of AVEA I.H.A.S. includes approximately 2 million from Aycell. TIM International agreed to sell its stake in TIM Hellas and Corporacion Digitel which companies represented 3.7 million subscriber lines. In addition, on March 24, 2005 TIM, through TIM International, finalized with T-Mobile Global Holding the sale of 7.16% of the share capital of CMobil (Dutch holding owning 60.8% of T-Mobile CZ). On May 5, 2005, regulatory authorities in Venezuela decided not to grant the authorization for the sale of TIM International's stake in Corporacion Digitel S.A. to CANTV. Because the decision is subject to administrative and judicial review and TIM International intends to pursue appropriate remedies, at March 31, 2005, TIM treated TIM Hellas and Digitel as discontinued operations. Consequently, as of March 31, 2005, TIM International managed 15.9 million lines, all in Latin America, excluding the lines of affiliated company AVEA. The lines of AVEA rose to 5.2 million as of March 31, 2005, from 4.8 million as of December 31, 2004.

Table of Contents**Item 3. Key Information****Dividends****3.4 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 period 2005-2007 at a level comparable to that paid out for 2004.

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 three fiscal years ended December 31, 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		
	Euro per Share	U.S. dollars per Share(2)	(millions of euro)	Euro per Share	U.S. dollars per Share(2)	(millions of euro)
2000(1)	0.3125	0.27	1,643.93	0.3238	0.28	664.84
2001	0.3125(3)	0.28	1,644.19	0.3237(3)	0.29	662.33
2002	0.1357(4)	0.13	713.47	0.1357(4)	0.13	273.11

(1) Dividends for 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) 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.

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

Dividends declared by Telecom Italia (formerly Olivetti). The following table sets forth the dividends per 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		
	Euro per Share	U.S. dollars per Share(2)	(millions of euro)	Euro per Share	U.S. dollars per Share(2)	(millions of euro)

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2000(1)(3)	0.0350	0.0299	254.87			
2001						
2002						
2003	0.1041	0.1278	1,072.95	0.1151	0.1413	667.11
2004(4)	0.1093	0.1431	1,226.99	0.1203	0.1575	697.25

- (1) Dividends for 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 April 7, 2005. 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, 2004 were clipped on April 18, 2005, and were payable from April 21, 2005.

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

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

Arrangements between Euroclear or Clearstream and Monte Titoli permit the shareholders to collect the dividends through Euroclear or Clearstream. Holders of American Depositary Receipts (ADRs) are entitled to receive payments in respect of dividends on the underlying 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 10.6 Taxation . Italian regulations do not contain any specific restrictions on the payment of dividends to non-residents of Italy. See Item 10. Additional Information 10.2 Exchange Controls and Other Limitations Affecting Security Holders .

Pursuant to Italian law, in connection with the payment of dividends, participants of Monte Titoli are required to supply to the Italian tax authorities certain information concerning the identity of non-resident shareholders holding 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 10.6 Taxation .

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Item 4. INFORMATION ON THE TELECOM ITALIA GROUP

4.1 BUSINESS

4.1.1 BACKGROUND

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

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

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

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

On August 4, 2003, Old Telecom Italia merged with and into Olivetti (the Merger) with Olivetti as the surviving company changing its name to Telecom Italia S.p.A. Please see 4.1.4 Significant Corporate Events during 2003 Merger of Old Telecom Italia 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. Following the Merger, Olimpia acquired additional shares through market purchases and, prior to certain transactions relating to the TIM Acquisition (see 4.1.3 Significant Developments During 2004 TIM Acquisition), Olimpia held approximately 17% of Telecom Italia's Shares, making it the largest shareholder of Telecom Italia.

On December 22, 2004 Olimpia's shareholders approved a capital increase in the amount of 2 billion in order to finance the acquisition of additional Shares. As a result on March 11, 2005, Olimpia announced that it had acquired 189,988,330 additional Shares for a total holding of 2,207,345,359 Shares, equal to approximately 20.4% of the ordinary share capital of Telecom Italia. In addition, as of March 14, 2005 the conversion of over 424 million Telecom Italia convertible bonds became effective, resulting in

Olimpia's aggregate shareholding representing approximately 21.4% of the outstanding Ordinary Shares, corresponding to 2,407,345,359 Shares.

Following the exchange of Tim shares held by third parties with new Shares, as a result of the merger of Tim into Telecom Italia through which the TIM Acquisition will be effected (see 4.1.3 Significant Developments During 2004 TIM Acquisition), Olimpia's stake is expected to be diluted to approximately 18%.

The share capital of Olimpia is presently held by Pirelli & C. S.p.A., Edizione Finance International S.A. (hereinafter Edizione), UniCredito Italiano S.p.A. (Unicredit), Banca Intesa S.p.A. (Intesa) and Hopa S.p.A. (Hopa) in the following respective proportions: 57.466%, 16.8%, 4.77%, 4.77% 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 7.1 Major Shareholders 7.1.1 The Olimpia Shareholders Agreements.

According to publicly available filings with Consob, as of May 23, 2005, shareholders of Pirelli with a 5% stake or greater in Pirelli's voting capital were Camfin CAM Finanziaria S.p.A. (25.387%) and Assicurazioni Generali S.p.A. (5.251%). Shareholders of Camfin CAM Finanziaria S.p.A. with a 5% stake or greater in the voting capital of the company included: Mr. Marco Tronchetti Provera (through Gruppo Partecipazioni Industriali S.p.A.) (50.180%); and Mr. Carlo Acutis (through Vittoria Assicurazioni SpA: 4.648%; and Yura International Holding BV: 4.649%).

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

As of April 7, 2005 (when Telecom Italia annual shareholders' meeting took place), Hopa directly and through Holinvest owned 461,364,703 Shares (equal to 4.02% of the outstanding Shares), while Pirelli directly owned 47,155,300 Shares.

The following chart illustrates our current ownership structure.

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

Note 2: Represents percentage ownership following certain transactions relating to the TIM Acquisition. As of the date hereof due to such transactions, Olimpia owns approximately 21.4% of the Telecom Italia Shares. After giving effect to the Shares to be issued in connection with the Merger of TIM into Telecom Italia, Olimpia's stake in Telecom Italia based on its ownership on the date hereof, is expected to be around 18%.

For the glossary of selected telecommunications terms used in the following description of the Telecom Italia Group's business and elsewhere in this Annual Report see Item 4. Information on the Telecom Italia Group 4.4 Glossary of Selected Telecommunications Terms .

4.1.2 GENERAL

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

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

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

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The Telecom Italia Group is a leader in the international information and communication technology sector. As leaders in wireline and mobile communications, Internet and media, information technology and R&D, its companies provide integrated and innovative services in Italy and certain countries outside of Italy. Moreover, the Telecom Italia Group also supplies office products and solutions, commercial systems and IT for gaming and lotteries.

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In its domestic Italian market, the Telecom Italia Group is both a technological and market leader in the fastest-growing segments (mobile, broadband and data transmission). Its international operations are concentrated mainly in Latin America, Europe and the Mediterranean basin.

In particular, at December 31, 2004, the Telecom Italia Group was one of the world's largest wireline operators, with approximately 26.0 million lines (including the equivalent ISDN lines). In addition, through TIM, the Telecom Italia Group is the leading mobile operator in Italy, with approximately 26.3 million lines. At March 31, 2005, TIM had approximately 15.9 million lines outside of Italy, through TIM's subsidiaries, resulting in a total of 42.1 million lines. Those lines exclude the lines of discontinued operations (Digitel and TIM Hellas) and the lines of AVEA, our Turkish joint venture. As of December 31, 2004 the lines calculated using the same criteria would have been 40.9 million.

TIM is one of the three mobile operators licensed to provide services using GSM 900 technology and one of the three operators licensed to provide services using GSM 1800 (formerly DCS 1800) technology. It is also one of five operators (of which four are in operation) holding a UMTS license to provide third-generation telephony services in Italy.

4.1.3 SIGNIFICANT DEVELOPMENTS DURING 2004

TIM Acquisition

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

- (i) a partial voluntary cash tender offer by Telecom Italia for 2,456,534,241 TIM ordinary shares, equivalent to two-thirds of the ordinary share free float, and for all 132,069,163 TIM savings shares (the "Cash Tender Offer"); and
- (ii) the merger of TIM into Telecom Italia after the effective spin-off of the domestic mobile communications business, currently operated by TIM, into a subsidiary wholly owned by TIM. The spin-off became effective on March 1, 2005. Such spin-off resulted in the beneficiary company taking over the authorization held by TIM for the provision of mobile communications services in Italy. The merger is expected to occur by the end of June 2005.

Following authorization by Consob, on January 3, 2005 Telecom Italia launched the Cash Tender Offer, which was completed on January 21, 2005; the consideration offered by Telecom Italia was equal to 5.60 per TIM ordinary and savings share.

In order to pay the consideration connected with the Cash Tender Offer, Telecom Italia used 2,504 million of its own funds; in addition, a pool of Italian and international banks granted Telecom Italia a line of credit for a maximum aggregate amount of 12,000

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million, divided into three tranches (the first equal to 3,000 million; the second equal to 6,000 million; and the third equal to 3,000 million) to be used to pay the portion of the consideration offered not covered by the amount to come from Telecom Italia.

The final result of the Cash Tender Offer was as follows: 2,639,154,665 ordinary shares (equal to approximately 31.2% of TIM ordinary share capital, and approximately 107.4% of the ordinary shares subject to the offer), and 8,463,127 savings shares (equal to approximately 6.4% of TIM savings share capital and the same percentage of savings shares subject to the offer) were tendered.

Although not all the conditions to effectiveness of the Cash Tender Offer were met, and specifically the number of savings shares tendered was less than the minimum number of 88,046,109 TIM savings shares, taking into account the overall number of shares tendered and the purpose of the restructuring plan, the aforesaid conditions were waived by the Board of Directors of Telecom Italia which, on January 23, 2005, confirmed the effectiveness of the Cash Tender Offer and the purchase of the TIM savings shares tendered. Since the number of TIM ordinary shares exceeded the maximum number of ordinary shares sought in the Cash Tender Offer, Telecom Italia prorated the acceptances on the basis of the number of ordinary shares tendered. The transfer to Telecom Italia of ownership of shares tendered and accepted took place on January 28, 2005. The total consideration paid by

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Telecom Italia was 13,804 million, 2,504 million of which was paid with Telecom Italia's own funds and 11,300 million was drawn from the line of credit made available in December by a pool of Italian and international banks (the residual amount on the first tranche of the line of credit, equal to 700 million, was cancelled). On February 11, 2005, the outstanding borrowings were reduced to 9,000 million with the first tranche of the line of credit repaid in the amount of 2,300 million.

On February 3, 2005 and February 11, 2005, respectively, Telecom Italia acquired 21 million TIM savings shares for a consideration of 117 million, and 42 million TIM ordinary shares for a consideration of 234 million, as a result of the exercise of an option agreement entered into in December 2004. In addition, following the completion of the Cash Tender Offer, Telecom Italia purchased 5,063,816 additional TIM savings shares through market transactions.

On January 23, 2005 the Board of Directors of Telecom Italia and TIM, adopted the plan to merge TIM with and into Telecom Italia.

Such merger plan confirmed the share exchange ratios for the reorganization plan which were first announced:

- (i) 1.73 Telecom Italia ordinary shares with a par value of 0.55 per share for each TIM ordinary share with a par value of 0.06 per share;
- (ii) 2.36 Telecom Italia savings shares with a par value of 0.55 per share for each TIM savings share with a par value of 0.06 per share.

The merger will be implemented through:

- (i) cancellation of the TIM ordinary shares held by TIM on the effective date of merger, without share exchange;
- (ii) cancellation of the TIM ordinary and savings shares held by Telecom Italia on the effective date of merger, without share exchange; and
- (iii) cancellation of the TIM ordinary and savings shares outstanding on the effective date of the merger, according to the exchange ratios indicated above. A capital increase of up to 1,421 million, through the issue of a maximum of 2,291,344,587 new Telecom Italia ordinary shares and a maximum of 291,729,714 new Telecom Italia savings shares, all with par value of 0.55 per share, will service the share exchange.

With effect from the 2005 fiscal year, Telecom Italia will prepare its interim and annual consolidated financial statements in accordance with IAS/IFRS and therefore for purposes of IAS/IFRS currently in force, the TIM Acquisition will be accounted for using the purchase method, i.e., by valuing the newly issued shares given in exchange to minority shareholders at their fair value at the effective date of the merger. The difference between the fair value of the newly issued shares and the portion of TIM shareholders equity acquired through the merger will be recorded as goodwill.

On completion of the merger, Telecom Italia ordinary shares and savings shares will continue to be listed on the Borsa Italiana S.p.A. screen-based trading market; they will also continue to be listed on the New York Stock Exchange as ADSs.

The merger of TIM into Telecom Italia was approved at an Extraordinary Meeting of the ordinary shareholders of Telecom Italia and TIM held on April 7, 2005 and April 5, 2005, respectively. The TIM savings shareholders approved the merger at a meeting held on April 6, 2005.

Notes Issue

In 2004, Telecom Italia S.p.A. issued four new series of notes under its 10 billion Euro Medium Term Note Program, authorized by the Board of Directors of Telecom Italia S.p.A. on October 10, 2003:

- on January 29, 2004 notes in the principal amount of 3,000 million were issued, divided into three tranches:
- notes 2004-2007 in the principal amount of 1,000 million with a quarterly coupon indexed to the Euribor 3-month rate plus 0.33%, issue price 99.927%, maturing on October 29, 2007;

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- notes 2004-2011 in the principal amount of 750 million with an annual fixed-rate coupon of 4.5%, issue price 99.56%, maturing on January 28, 2011; and
- notes 2004-2019 in the principal amount of 1,250 million with an annual fixed-rate coupon of 5.375%, issue price 99.07%, maturing on January 29, 2019;
- on April 8, 2004, notes in the principal amount of 110 million with a quarterly coupon indexed to the Euribor 3-month rate plus 0.60%, maturing on March 30, 2009 were issued at par. Such notes were subscribed in full, by way of a private placement, by one investor;
- on June 24, 2004, notes in the principal amount of GBP850 million were issued with an annual fixed-rate coupon of 6.375%, issue price 98.85%, maturing on June 24, 2019;
- on November 23, 2004, notes in the principal amount of 120 million with a quarterly coupon indexed to the Euribor 3-month rate plus 0.66%, maturing on November 23, 2015 were issued at par. Such notes were subscribed in full by way of a private placement.

On October 6, 2004 Telecom Italia Capital S.A., a wholly-owned subsidiary of Telecom Italia S.p.A., issued fixed-rate multi-tranche notes in U.S.\$ in the principal amount of U.S.\$3,500 million, with a full and unconditional guarantee by Telecom Italia S.p.A. Such notes were divided into three tranches:

- notes 2004-2010 in the principal amount of U.S.\$1,250 million with an annual fixed-rate coupon of 4%, issue price 99.732%, maturing on January 15, 2010;
- notes 2004-2014 in the principal amount of U.S.\$1,250 million with an annual fixed-rate coupon of 4.95%, issue price 99.651%, maturing on September 30, 2014; and
- notes 2004-2034 in the principal amount of U.S.\$1,000 million with an annual fixed-rate coupon of 6%, issue price 99.081%, maturing on September 30, 2034.

On October 14, 2004, Telecom Italia Capital S.A., a wholly-owned subsidiary of Telecom Italia S.p.A., completed an exchange offer in respect of:

certain debt securities (the Notes) issued on October 29, 2003 (which were not registered with the United States Securities and Exchange Commission SEC) in the total amount of U.S.\$4 billion, divided into three tranches (Series A, Series B and Series C) and

newly-issued Notes registered with the U.S. Securities and Exchange Commission.

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The newly-issued Notes were registered under the United States Securities Act of 1933 and contained the same terms and conditions as those of the corresponding unregistered Notes. The Notes are unconditionally guaranteed by Telecom Italia. By the end of the exchange offer period, U.S.\$3,957,588,000 of the unregistered Notes (U.S.\$985,926,000 of Series A Notes, U.S.\$1,972,460,000 of Series B Notes and U.S.\$999,202,000 of Series C Notes) had been exchanged, representing approximately 98.94% of the nominal amount of the Notes issued in October 2003.

The Telecom Italia Board of Directors at its meeting held on November 9, 2004 authorized the issue of non-convertible notes for a maximum amount of 4.9 billion to be issued by December 31, 2006 and granted a full guarantee to Telecom Italia Capital S.A. for any further note issues up to a maximum of U.S.\$5 billion.

Italian Antitrust Authority

On November 19, 2004 the Antitrust Authority notified the closure of its investigation A351, pursuant to which Telecom Italia was fined 152 million for alleged abuse of dominant position. Telecom Italia petitioned the Lazio Administrative Tribunal for annulment of the decision. On February 16, 2005 the Lazio Administrative Tribunal issued an order granting Telecom Italia's request for suspension but only as regards the imposition of the fine. Subsequently, on February 22, 2005, the decision on the merits of the case was filed, showing that Telecom Italia's petition had been granted in part. The final decision, published on May 11, 2005, completely cancelled the fine. The decision of the Lazio Administrative Tribunal can be appealed to the State Council. In 2004 Telecom Italia accrued the full amount of the fine to a specific risk reserve.

Merger of IT Telecom and EPIClink into Telecom Italia

On September 9, 2004, the Board of Directors of Telecom Italia S.p.A. examined and approved the plan for the merger of the wholly-owned subsidiaries IT Telecom S.p.A. and EPIClink S.p.A. into Telecom Italia. This plan falls under a broader reorganization of the Information Technology Group area.

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Bringing the activities of these two subsidiaries inside Telecom Italia will make it possible to rationalize the use of resources and technological expertise and will lead to an important simplification of the operational, administrative and corporate management processes.

As provided by the respective bylaws, the merger was approved on October 11, 2004 by the Boards of Directors of the three companies, in accordance with the Italian Civil Code.

The merger is effective from December 31, 2004 and for accounting and tax purposes from January 1, 2004. On December 30, 2004, IT Telecom S.p.A. conferred its Data Center business segment to IT Telecom S.r.l., a new company set up on November 12, 2004.

The Antitrust Authority has begun an investigation into TIM, Vodafone and Wind

At its meeting on February 23, 2005, the Antitrust Authority resolved to commence an investigation of TIM, Vodafone Omnitel N.V. and Wind Telecomunicazioni S.p.A., to ascertain whether they had violated articles 81 and 82 of the EC Treaty.

The investigation followed complaints by a number of telecommunications operators, alleging that TIM, Vodafone and Wind had abused their dominant position on the market for access to the cellular telephone infrastructure network and the individual mobile networks termination market, and had concluded agreements on the access market, the final mobile telephony services market, and in the commercial offerings for their business customers.

Firstly, it is alleged that TIM, Vodafone and Wind, which together hold a dominant position over network infrastructure, had refused to negotiate access agreements with the purpose of preventing entry to the mobile communications services retail market by any alternative operators, including MNVO (Mobile Virtual Network Operators), ESP (Enhanced Service Providers) and Resellers. Moreover, it is alleged that such conduct, performed homogeneously and simultaneously by all three mobile telephony operators against all the applicant operators, might also constitute an anti-competitive agreement.

Secondly, the investigation will examine the alleged cases of abuse by TIM, Vodafone and Wind, each of which has a dominant position over their own mobile networks, whereby they allegedly charge their competitors higher prices for their landline-mobile termination services than those charged to their own business customers for the entire integrated landline-mobile service. More specifically, TIM, Vodafone and Wind are alleged to practice favorable financial or technical conditions for their own commercial divisions for the sale of terminal services, designed to exclude their competitors from the business customer integrated services market, in violation of article 82 of the EC Treaty.

Lastly, the three mobile operators have allegedly engaged in commercial practices designed to prevent telecommunications operators from using business contract re-sell services to their end customers, thereby preventing any kind of competition on the mobile services retail market. Such conduct allegedly had the same effects of excluding competition; such conduct by all three

companies could be the result of an agreement to restrict competition. It is alleged that this conduct would appear to be prejudicial to trade between the member states of the European Community by virtue of the fact that it affects a substantial part of the common market, and for that reason violates articles 81 and 82 of the EC Treaty.

The investigation will be concluded by April 28, 2006.

4.1.4 SIGNIFICANT CORPORATE EVENTS DURING 2003

Merger of Old Telecom Italia with Olivetti

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 controlling shareholder 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

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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 Shares 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. 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. 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. Subsequent to the Merger Olimpia, through a series of transactions, increased its stake to approximately 17%. This made Olimpia Telecom Italia's largest shareholder. As a result of certain transactions entered into in connection with the TIM Acquisition, Olimpia currently holds a stake of approximately 21.4% which following the merger of TIM into Telecom Italia will be reduced to approximately 18%. See 4.1.3 Significant Developments During 2004 TIM Acquisition.

SEAT Spin-off

On April 1, 2003, the Board of Directors of SEAT approved the 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.

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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.

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 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.

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- *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 shares resulting from the exercise of the J.P. Morgan Chase put option for which Telecom Italia paid 2,272 million. The JPMorgan Chase put option related 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. 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 the sale (648 million), the transaction allowed Telecom Italia to reduce its net financial consolidated debt by 3,681 million.

The agreements relating to the sale of Telecom Italia's stake in New SEAT included 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 provided 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.

4.1.5 DISPOSITION AND ACQUISITION OF SIGNIFICANT EQUITY INVESTMENTS IN 2004**V DISPOSITIONS****Sale of shares in Euskaltel**

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On January 16, 2004, Telecom Italia International N.V. signed a contract with Araba Gertu S.A. for the sale of a 3.1% stake in Euskaltel to Araba Gertu S.A. for a total price of 13.6 million. The closing took place on February 19, 2004. Iberdrola S.A., an Euskaltel shareholder, exercised its preemption right. As a result Telecom Italia International N.V. sold 149,231 shares to Araba Gertu for consideration of 12.1 million and 18,719 shares to Iberdrola for consideration of 1.5 million. Upon completion of the transaction, Telecom Italia International retains a 3% share in Euskaltel.

Sale of shares in Telekom Austria

On January 27, 2004, Telecom Italia International N.V. sold its entire remaining 14.78% investment in the share capital of Telekom Austria for a total net value of 768 million. A net gain was realized on consolidation for 62 million.

Sale of Netco Redes S.A.

On March 4, 2004, Telecom Italia International N.V. signed a contract with Auna for the sale of its entire 30% investment in the Spanish company Netco Redes S.A. for consideration of 30 million. On June 24, 2004, following the fulfillment of the conditions precedent stated in the contract (including the receipt of authorization from the competent Spanish authorities), Telecom Italia International N.V. transferred 301,404 Netco Redes S.A. shares to Auna, receiving the entire agreed amount of consideration of 30 million, including interest accrued up

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to the closing date, on June 30, 2004. After this sale, the only equity interest currently held by Telecom Italia International N.V. in Spain is represented by the 3% holding in Euskaltel. A net gain was realized on consolidation for 6 million.

Sale of Pirelli & C. Real Estate S.p.A. shares

During the period June-August 2004, Telecom Italia S.p.A. sold all the Pirelli & C. Real Estate S.p.A. in its portfolio (812,086 shares) for total cash proceeds of 24 million.

Sale of Sky Italia S.r.l.

On September 28, 2004, Telecom Italia sold its 19.9% interest in Sky Italia to NewsCorp group. The consideration for the transaction was 88 million. The transaction gave rise to a gain of 31.4 million. This made it possible to cancel the effects of the write-downs made during the first half of the year so that the transaction had an almost nil economic impact on Telecom Italia's financial statements for 2004.

Sale of Mirror International Holding S.a.r.l.

On December 21, 2004, Mirror International Holding S.a.r.l. purchased, through a buyback, 30% of its capital held by Telecom Italia. Consideration for the transaction was 75 million, 73 million for the sale and 2 million for a loan repayment. The deal resulted in a gain on consolidation of 24 million for the above sale and a release of 61 million relating to the remaining part of the gain on the sale, in 2001, of 70% of Mirror International Holding, the company to which the investments in the satellite consortium had previously been transferred.

v ACQUISITIONS

Purchase of a 40% stake in Finanziaria Web by Telecom Italia Media

At the end of June 2004, an agreement was reached to settle the dispute concerning the framework agreement signed on September 20, 2000 between Seat Pagine Gialle S.p.A. (now Telecom Italia Media) and its subsidiaries and the companies in the De Agostini group, regarding, among other things, the purchase of 40% of Finanziaria Web (which already held a 66% stake in Matrix, owner of the Virgilio portal).

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In particular, based on the agreement which supersedes that of September 20, 2000 De Agostini Invest transferred the entire investment held in Finanziaria Web to Telecom Italia Media (which already had control of the company with a 60% holding) for consideration of 287 million, in lieu of the originally agreed price of 700 million. In addition to this amount, 38 million was added to reimburse De Agostini Invest for the expenses sustained to cover the losses and recapitalize Finanziaria Web starting from July 2001.

On the financial front, the agreement led to an immediate and temporary increase of 325 million in Telecom Italia Media's indebtedness. Telecom Italia, in keeping with the commitments undertaken in 2003 when control was relinquished in Nuova Seat Pagine Gialle (the beneficiary company of the partial spin-off of Seat Pagine Gialle S.p.A., now Telecom Italia Media), so that Telecom Italia Media would have the resources necessary to meet the liabilities and commitments existing at the date the spin-off took effect made a loan of 280 million at market rates to the company on June 28, 2004.

Two additional transactions were entered into by Telecom Italia Media that are related to this transaction in order to improve its financial and equity position:

- sale of the investment in Finanziaria Web purchased from De Agostini Invest, carried out on July 9, 2004, to Vertico (a wholly-owned subsidiary of Telecom Italia, indirectly, and a shareholder of Matrix with a 33.3% holding) for a price of 42.6 million. This sale has allowed Telecom Italia Media to reduce its financial exposure with Telecom Italia while maintaining its control over Matrix and, on the other hand, consolidating its commercial cooperation relationships in the Internet area that already exist between Telecom Italia and Matrix/Virgilio;
- a share capital increase for a total equivalent amount of 120 million approved by the Extraordinary Shareholders Meeting on September 10, 2004 and entirely subscribed to during the rights offer period (October 11 - 29, 2004) and during the offer period on the stock market for the remaining unexercised rights (November 8 - 12, 2004).

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Telecom Italia subscribed to its share of the capital increase equal to 352,692,582 new ordinary shares, for a total equivalent amount of approximately 74 million, equal to 62.50% of all ordinary shares offered, and 30,239 new savings shares, for a total equivalent amount of approximately 0.5 million, equal to 0.32% of all savings shares offered.

The economic impact of the above transactions was a loss, net of the tax effect, of 130 million for Telecom Italia Media and 112 million for the Company. The net loss of the Telecom Italia Group on consolidation was 116 million.

Purchase of Digitel shares by TIM International N.V.

With regard to the numerous disputes pending between TIM International and the other shareholders in Digitel, in relation to the absorption of the loss for the year 2002, a settlement agreement was reached in April 2004 whereby TIM International agreed to purchase the holdings of all the other shareholders corresponding to 32.88% of Digitel's share capital.

According to the agreement, executed on July 1, 2004, TIM International purchased 1,480,562 shares held by the minority shareholders of the Venezuelan company for U.S.\$109.6 million. The closing took place after satisfaction of the contractual conditions put into place to protect TIM International and Digitel. As from the date of July 1, 2004, TIM, through TIM International, holds 100% of the shares of the Venezuelan mobile operator.

On November 5, 2004, a memorandum of understanding for the sale of Corporacion Digitel was reached by TIM and CANTV (Compañía Anónima Nacional Teléfonos de Venezuela). The completion of the transaction was conditional upon the execution of definitive agreements and obtaining all the necessary approvals from the competent Venezuelan authorities.

On May 5, 2005, the regulatory authorities in Venezuela decided not to grant the authorization for the sale of TIM International's stake in Corporacion Digitel S.A. to CANTV. The decision is subject to administrative and judicial review. TIM International intends to pursue appropriate remedies.

Capital increases by Etec S.A. Cuba

During the first half of 2004, the Shareholders' Meeting of the Cuban company Etec S.A. voted three increases in share capital in order to fund the extraordinary financial requirements for the payment of the new license granted by MIC (the Ministry of Cuban Telecommunications). The share capital increases have the following characteristics:

- on March 4, 2004, U.S.\$23.8 million through the issue of 165 new shares for a unit price of U.S.\$144.190;

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- on May 20, 2004, U.S.\$31.6 million through the issue of 219 new shares for a unit price of U.S.\$144.190;
- on June 14, 2004, U.S.\$61.9 million through the issue of 429 new shares for a unit price of U.S.\$144.190.

Telecom Italia International N.V. subscribed to such increases based on its investment (27%) paying, respectively, U.S.\$6.3 million, U.S.\$8.5 million and U.S.\$16.7 million, and receiving in exchange, respectively, 44, 59, and 116 new shares.

Telecom Italia International N.V. s interest remained unchanged.

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4.1.6 RECENT DEVELOPMENTS DURING 2005

In addition to the TIM Acquisition, described under 4.1.3 Significant Developments During 2004, following are certain material events which have occurred since December 31, 2004.

Sale of Entel Chile S.A.

On January 24, 2005 Telecom Italia International N.V. executed a stock purchase agreement with Almendral S.A., a Chilean holding company publicly traded at the Santiago's Stock Exchange, for the sale of all its 129,530,284 shares (54.76% of the share capital) of Entel Chile S.A. for a total consideration of U.S.\$934 million.

The transaction closed on March 29, 2005 and Telecom Italia International N.V. received an initial payment of U.S.\$834 million. The remaining amount (U.S.\$100 million) was paid on May 24, 2005.

This transaction falls under the Telecom Italia Group's strategy to rationalize its international portfolio and focus on areas of strategic interest with growth potential.

Telecom Italia convertible notes 2001-2010

After December 31, 2004, Telecom Italia received requests to convert the 2001-2010 convertible notes issued by Telecom Italia prior to March 10, 2005 the last day before the suspension of conversion rights before the annual shareholders' meeting called to approve the annual financial statements (such conversion rights being again open to exercise as of April 19, 2005, ex dividend) in the principal amount of 1,877,880,881 corresponding to approximately 885,520,209 Telecom Italia ordinary shares. From April 19, 2005 (first day after the end of the conversion suspension period) through May 13, 2005 Telecom Italia received additional conversion requests for 182,712 principal amount of notes corresponding to 86,147 Telecom Italia ordinary shares. The conversion resulted in a reduction of net financial debt by approximately 2 billion under Italian GAAP.

Bond Buyback

Since the beginning of 2005, Telecom Italia Finance S.A. has made certain market purchases of its own notes (originally 3,000 million, 6.125% coupon, maturing April 20, 2006, with a remaining principal amount of 2,745 million at December 31, 2004) in the principal amount of 153 million. After the buyback, the principal amount of the debt outstanding is equal to approximately 2,592 million.

In April and May 2005, Telecom Italia Finance S.A. also made market purchases of a principal amount of 141 million of its own 1% coupon convertible notes, maturing November 3, 2005, and 195 million in principal amount of its own 1% coupon exchangeable notes, maturing March 15, 2006.

Sale of Databank

On March 14, 2005 Telecom Italia Media completed the sale of its 100% stake in its subsidiary Databank S.p.A. which operated in market research and sector surveys, to Centrale dei Bilanci S.r.l. and Cerved Business Information S.p.A., each of which is acquiring 50% of the share capital.

The sale price is equal to 5 million, in line with the company's book value. This operation is a further step in the process of rationalization of Telecom Italia Media Group's portfolio, exiting from activities not in synergy with the core business.

New Bond Issue

On March 17, 2005, Telecom Italia issued a new bond under its 10 billion EMTN Programme in the principal amount of 850 million, with an annual fixed-rate coupon of 5.25%, issue price 99.667%, maturing on March 17, 2055. The issue is part of the Telecom Italia Group's debt refinancing plan.

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Sale of CMobil B.V.

On March 24, 2005 TIM, through TIM International, finalized with T-Mobile Global Holding the sale of 7.16% of the share capital of CMobil (Dutch holding owning 60.8% of T-Mobile CZ). This participation corresponds to an indirect stake of 4.35% in T-Mobile CZ, one of the two largest operators in the Czech Republic. The overall value for this operation is 70.5 million.

Agreement for the sale of TIM Hellas

On April 3, 2005 TIM International reached an agreement for the disposal of its 80.87% equity stake in TIM Hellas to funds advised by Apax Partners and Texas Pacific Group (TPG). The price of the transaction is 1,114 million which corresponds to an enterprise value of 1,600 million for 100% of TIM Hellas and is equivalent to approximately 16.43 per share.

The closing of the transaction, subject to, among other things, the approval by the competent authorities, is expected to occur by the end of July 2005.

Agreement for the purchase of Liberty Surf from Tiscali

On April 5, 2005 Telecom Italia and Tiscali signed an agreement by which Telecom Italia will purchase Tiscali's 95% stake in Liberty Surf S.A., a French company listed on the Euronext in Paris.

The price agreed for Tiscali's stake is approximately 266 million, valuing 100% of Liberty Surf at 280 million. This valuation takes into account Liberty Surf's net cash of approximately 28 million and corresponds to an estimated enterprise value of 252 million for 100% of the company.

Following the approval of the transaction by the French antitrust authorities (obtained on May 12, 2005) the closing is expected to take place on May 31, 2005.

Once the transaction is finalized, Telecom Italia will launch a public offer for the remaining 5% of Liberty Surf's share capital, as required by law.

Liberty Surf is a leading Internet Service Provider in France, with a nationwide presence. Through its own network infrastructure, it provides services to approximately 344,000 broadband customers and approximately 700,000 dial-up customers (of which 448,000

retail). The company's 2004 revenues totaled approximately 225 million.

Restructuring of the Telecom Italia Group Internet activities

In the process of rationalizing the Telecom Italia Group activities, and in accordance with the decisions of the Boards of Directors of Telecom Italia and Telecom Italia Media of April 4, 2005, Telecom Italia and Telecom Italia Media concluded, on April 19, 2005, agreements for the acquisition by Telecom Italia of the Virgilio assets (owned by the Webfin and Matrix companies) and Tin.it. The transaction entails the acquisition by Telecom Italia of the following stakes currently owned by Telecom Italia Media:

- 60% stake in Webfin (which currently owns 66% of Matrix) and 0.7% stake in Matrix, for a total price of 70 million. At the completion of the transaction, Telecom Italia, which already owns 40% of Webfin and 33.3% of Matrix, will own 100% of Webfin and Matrix, and will therefore have full control over the activities of Virgilio;
- 100% stake in a new company yet to be established to which Telecom Italia Media will transfer the business of Tin.it. The purchase price for the transfer of the assets will be 880 million.

The operation will entail, among other things:

- the use by Telecom Italia Media of the proceeds from the sale for new investments in the media sector, in the estimated amount of 250 million in the three-year period 2005-2007;
- the purchase, through a tender offer, by Telecom Italia Media of its own shares, up to the maximum amount permitted by law, in the amount of approximately 148 million;

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- the payout by Telecom Italia Media of dividends in 2006 currently estimated at approximately 550 million subject to financial and industrial requirements; and
- the merger by incorporation of La7 Televisioni into Telecom Italia Media.

The shareholders' meeting of Telecom Italia Media held on May 24, 2005 approved:

- the authorization to acquire up to 10% of ordinary and savings shares, at a price of 0.40 per ordinary share and 0.33 per savings share, respectively, in the maximum amount of approximately 148 million;
- the reduction of the company's legal capital by the cancellation of shares so acquired.

The buyback by way of a tender offer is expected to occur after authorization by the Consob has been received.

The economic terms of the acquisition are in line with the valuation based on the sale of Internet assets and entail a premium of approximately 20% over the average official price quoted on the stock exchange in the six months preceding and including April 1, 2005, the last trading day prior to the announcement of the transaction.

Telecom Italia will not participate in the buyback and the entire value of the tender offer will hence be distributed to the market. If the tender offer succeeds fully and Telecom Italia Media cancels all acquired shares, Telecom Italia's stakes in Telecom Italia Media (direct stake of 60.4% and indirect stake, through Telecom Italia Finance, of 2.1%) would increase from 62.5% to 69.4% in the aggregate.

Agreement for the sale of Finsiel S.p.A. to the COS Group

On April 26, 2005 Telecom Italia signed a sale and purchase agreement with Almoviva Technologies, the COS Group holding company, for the sale of its entire stake (79.5%) in Finsiel S.p.A.. The execution of this agreement completes a competitive sale process for the controlling stake held by Telecom Italia in Finsiel S.p.A. and follows a preliminary agreement signed with Almoviva Technologies on February 24, 2005. The transaction is based upon a Finsiel enterprise value of approximately 164 million.

The closing of the transaction, subject to, among other things, the approval by the competent authorities, is expected to occur by the end of July 2005. At the closing Telecom Italia will sell 59.6% of Finsiel's share capital, while the remaining stake (19.9%) will be transferred by the end of 2005, after the exercise of a put/call option.

Following the preliminary agreement, Telecom Italia adjusted Finsiel's carrying value to its estimated sales value in its consolidated financial statements. Therefore, in the consolidated financial statements, a provision of 27 million was set aside in a specific reserve. This transaction also allowed for the booking, in the 2004 financial statements, of deferred tax assets for 38 million, arising from a 115 million write-down of Finsiel's book value, made by Telecom Italia in fiscal year 2002.

Agreement between Telecom Italia Group and Brasil Telecom

On April 28, 2005, Telecom Italia's subsidiary, TIM Brasil, and Brasil Telecom reached an agreement of strategic significance which management believes will allow the Telecom Italia Group to achieve significant economies of scale, better exploiting the synergies resulting from the integration of the fixed and mobile platforms in Brazil.

The agreement, which entails a series of transactions requiring the approval of the relevant Brazilian authorities, calls for: (i) the merger of Brasil Telecom Celular (BRTC), a company 100%-controlled by Brasil Telecom and operating mobile services in Region 2, into TIM Brasil; (ii) the development of commercial and marketing activities, combining the two groups' technological know-how, services and distribution networks; (iii) the elimination of existing regulatory overlapping licenses.

In particular, TIM Brasil will relinquish its long distance license and will avail itself of the transport services of Brasil Telecom, and Brasil Telecom will acquire a minor equity participation in TIM Brasil and will place its sites and infrastructure at the disposal of TIM Brasil, thus accelerating plans for the development of network coverage.

The agreement is designed to, inter alia, meet the requirements of the Brazilian Telecommunications Authority (ANATEL) aimed at resolving the issue of the overlapping mobile and long-distance licenses of the two groups.

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In addition, on April 28, 2005, Telecom Italia Group agreed to finally settle pending litigation against Brasil Telecom and its controlling shareholders.

Agreement between Telecom Italia Group and Opportunity Group

Concurrently with the above mentioned agreement, Telecom Italia reached an agreement with the Opportunity Group with respect to resuming the Telecom Italia Group's role in the management of the operations of Brasil Telecom, through the restoration of the exercise of its governance rights temporarily suspended since August 2002 within the controlling group of Brasil Telecom.

The restoration of Telecom Italia International's shareholder position in Solpart; the recovery of and the exercise of its governance rights, as provided for in the relevant shareholders' agreement; and the strength of the industrial agreement between TIM Brasil and Brasil Telecom, better position the Telecom Italia Group to develop synergies between fixed and mobile platforms in this rapidly expanding market.

Furthermore, Telecom Italia has agreed to buy certain indirect interests held by Opportunity in Brasil Telecom and, at the same time, Telecom Italia and Opportunity have reached an agreement to settle a number of potential legal challenges and disputes. The agreement entails a payment by Telecom Italia of 341 million to settle the dispute and acquire Opportunity's interests. The acquisition of Opportunity's stakes will be finalized either when an agreement is reached with other indirect shareholders in Brasil Telecom or within 24 months at the latest, subject to the satisfaction of certain contractual conditions precedent.

Two legal proceedings were commenced in early May 2005 by certain indirect shareholders of Solpart with regard to the settlement reached in April 2005 by the Telecom Italia Group with Opportunity and its controlled entities.

In the first action, the plaintiffs have requested authorization to intervene in the proceeding for the approval of the settlement agreement relating to actions brought in January and March 2004 by Telecom Italia International against Techold, Timepart, Solpart and others before the civil court of Rio de Janeiro.

In the second action, the plaintiffs have requested that the court enjoin the effects of the shareholder agreement as amended on April 28, 2005 pursuant to which Telecom Italia International's governance rights in Solpart have been restored.

Separately, injunctive relief has been sought before the court in Rio de Janeiro against Telecom Italia International, TIM International, TIM Brasil, Opportunity, Techold, Timepart, Solpart, Brasil Telecom Participações, Brasil Telecom and its subsidiary

Brasil Telecom Celular, to block the merger of Brasil Telecom Celular into TIM Brasil pursuant to the agreement reached by the two companies on April 28, 2005.

La7 Agreement for the purchase of Elefante TV S.p.A. and Delta TV S.p.A.

On April 29, 2005, La7 signed an agreement with Elefante TV S.p.A. to acquire the company's national TV broadcast unit for 115.5 million. Elefante TV holds a private television broadcasting concession for terrestrial frequencies over the national territory. The company also holds an authorization for digital broadcasting.

On the same date, La7 signed an agreement to purchase radio/television plants and frequencies from local concession holder Delta TV, which operates in Central and Southern Italy, for a total amount of 12 million.

The closing of the transactions is subject to, among other things, the approval by the competent authorities.

Sale of Corporacion Digital C.A. (Venezuela) shares by TIM International N.V.

On May 5, 2005, the Venezuelan telecommunications authority decided not to grant the authorization for the sale of 100% of the share capital of Corporacion Digital C.A. by TIM International to the national operator CANTV, announced in November 2004.

The decision is subject to administrative and judicial review and TIM International intends to pursue appropriate remedies.

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

The following is a chart of the Telecom Italia Group's Business Units/Corporate Functions as of December 31, 2004:

-
- (1) On April 3, 2005 an agreement was reached to dispose of the equity interest held in TIM Hellas. The closing of the transaction, subject to, among other things, the approval by the competent authorities, is expected to occur by the end of July 2005.
 - (2) Mobile South America.
 - (3) On November 5, 2004, a memorandum of understanding for the sale of Corporacion Digitel was reached by TIM with CANTV (Compania Anonima Nacional Teléfonos de Venezuela). On May 5, 2005, regulatory authorities in Venezuela decided not to grant authorization for the proposed sale. The decision is subject to administrative and judicial review and TIM International intends to pursue appropriate remedies.
 - (4) Not operational as of December 31, 2004. Company receiving domestic mobile assets spun-off by TIM as a preliminary step to completion of the TIM Acquisition.
 - (5) On January 24, 2005 Telecom Italia International N.V. executed an agreement for the disposal of its 54.76% equity stake in Entel Chile S.A. to Almendral S.A., a holding company listed on the Santiago Stock Exchange in Chile; the price for the transaction is U.S.\$934 million, which corresponds to a value of U.S.\$1,706 million for 100% of Entel S.A.. The transaction closed on March 29, 2005.
 - (6) On April 4, 2005 the Boards of Directors of Telecom Italia and Telecom Italia Media authorized the restructuring of the Telecom Italia Group's Internet business whereby Telecom Italia will acquire all of Telecom Italia Media's Internet activities. The proceeds of such sale will be used by Telecom Italia Media to, among other things, expand its business.
 - (7) On April 26, 2005 Telecom Italia signed a sale and purchase agreement with Almaviva Technologies, the COS Group holding company, for the sale of its entire stake (79.5%) in Finsiel S.p.A.. The transaction is based upon a Finsiel enterprise value of approximately 164 million.
 - (8) On December 31, 2004, the merger of IT Telecom and EPIClink with and into Telecom Italia became effective.
 - (9) On April 5, 2005, Olivetti Tecnost S.p.A. was renamed Olivetti S.p.A..

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

		Wireline		South America		Internet and Media		IT Market	IT Group	Olivetti Tecnost	Sub-total	Other activities and eliminations	Consolidated Total
		(2)	Mobile(3)	(4)	(5)	(2)(6)	(2)	(7)			(2)(4)(8)		
(millions of Euro, except number of employees)													
Gross operating revenues	2004												
	2003(1)	17,571	12,900	1,076	597	729	965	601	34,439		(3,202)	31,237	
		17,216	11,782	1,111	1,297	891	1,100	655	34,052		(3,202)	30,850	
	2002(1)	17,047	10,867	1,405	1,991	1,039	996	914	34,259		(2,851)	31,408	
Operating income	2004												
	2003(1)	5,199	4,073	121	(89)	36	(67)	21	9,294		(2,094)	7,200	
		4,969	3,786	145	63	58	(36)	2	8,987		(2,198)	6,789	
	2002(1)	4,677	3,358	154	232	64	(40)	4	8,449		(2,391)	6,058	
Capital expenditures	2004												
	2003(1)	2,201	2,490	157	62	25	180	15	5,130		205	5,335	
		2,302	1,957	129	102	30	174	20	4,714		180	4,894	
	2002(1)	2,475	1,715	214	81	39	149	35	4,708		193	4,901	
Number of employees at the year end	2004												
	2003(1)	50,383	20,361	5,080	1,805	4,131	3,160	2,108	87,028		4,337	91,365	
		50,766	18,888	4,953	2,029	4,827	4,107	2,395	87,965		5,222	93,187	
	2002(1)	53,935	18,702	5,403	7,715	5,506	5,039	4,527	100,827		5,793	106,620	

(1) The data relating to 2003 and 2002 have been reclassified and presented consistent with the 2004 presentation.

(2) Starting from January 1, 2003, the NETikos group, the Webegg group, TILab, Loquendo and Eustema are no longer consolidated by the IT Group Operating Activity. BBNed is no longer included in Other Activities. TILab moved to Other activities and Loquendo and BBNed became part of Wireline, whereas the other companies moved to the IT Market Business Unit. The effects of such reclassifications were not material.

(3) On April 3, 2005 an agreement was reached to dispose of the equity interest held in TIM Hellas. The closing of the transaction, subject to, among other things, the approval by the competent authorities, is expected to occur by the end of July 2005. On November 5, 2004, a memorandum of understanding for the sale of Corporacion Digitel was reached by TIM with CANTV (Compania Anonima Nacional Telefonos de Venezuela). On May 5, 2005, regulatory authorities in Venezuela decided not to grant authorization for the proposed sale. The decision is subject to administrative and judicial review and TIM International intends to pursue appropriate remedies.

(4) The data refer to Entel Chile Group and Entel Bolivia Group. 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

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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 our chosen strategy to consolidate and develop our international presence in the Latin America geographical area. The Wireline and Mobile business units with their present corporate organizational structure are nevertheless responsible for the results of the subsidiaries in Latin America under their control. As a result of this reorganization and with effect on January 1, 2004, the company Telecom Italia Latam S.A. and the business segment South America of Telecom Italia are included in Other activities.

On January 24, 2005 Telecom Italia International N.V. executed an agreement for the disposal of its 54.76% equity stake in Entel Chile S.A. to Almendral S.A., a holding company listed on the Santiago Stock Exchange in Chile; the price for the transaction is U.S.\$934 million, which corresponds to a value of U.S.\$1,706 million for 100% of Entel S.A.. The transaction closed on March 29, 2005.

- (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 8, 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 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.

On April 4, 2005 the Boards of Directors of Telecom Italia and Telecom Italia Media authorized the restructuring of the Telecom Italia Group's Internet business whereby Telecom Italia will acquire all of Telecom Italia Media's Internet activities. The proceeds of such sale will be used by Telecom Italia Media to, among other things, expand its business.

- (6) On April 26, 2005 Telecom Italia signed a sale and purchase agreement with Almoviva Technologies, the COS Group holding company, for the sale of its entire stake (79.5%) in Finsiel S.p.A.. The transaction is based upon a Finsiel enterprise value of approximately 164 million.

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

- (8) The data include the operations of the International Affairs Corporate Function, 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 Telecom 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, the staff functions, the company Telecom Italia Latam S.A. and the business segment South America of Telecom Italia.

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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,		
	2002	2003	2004
Wireline:			
Subscriber fixed-lines at period-end in Italy (thousands)(1)	27,142	26,596	25,957
Subscriber fixed-line decline per annum in Italy(%)	(0.8)	(2.0)	(2.4)
ISDN equivalent lines at period-end in Italy (thousands)(2)	5,756	6,027	5,805
Broadband Access in Italy and abroad (ADSL + XDSL) (thousands)(3)	850	2,200	4,430
Voice Offers in Italy (thousands)(4)	5,224	5,547	5,883
Network infrastructure in Italy:			
access network in copper (millions of km pair)	104.3	105.2	105.2
access network and transport in fiber optics (millions of km of fiber optics)	3.6	3.6	3.7
Network infrastructure abroad:			
European backbone (km of fiber optics)	36,600	39,500	39,500
Retail Traffic(5):			
Average minutes of use per fixed-line subscriber in Italy during period(6)	4,292	4,127	3,935
<i>Of which:</i>			
Local traffic during period (in average minutes)(7)	3,198	2,971	2,749
Long-distance traffic during period (domestic and international) (in average minutes)	1,094	1,156	1,186
Total mobile outgoing traffic per month (millions of minutes)	1,960	2,090	2,211
Mobile:			
TIM lines in Italy at period-end (thousands)	25,302	26,076	26,259
TIM group foreign lines (at period-end, thousands)(8)	13,809	18,438	27,563
TIM group lines total (Italy + foreign, thousands)(8)	39,111	44,514	53,822
TIM lines in Italy growth per annum(%)	5.7	3.1	0.7
Average revenue in Italy per mobile line per month() (9)	28.8	29.1	30.0
Cellular penetration in Italy at period-end (TIM lines per 100 inhabitants)(%)	43.9	45.3	45.5
Cellular market penetration in Italy at period-end (lines for the entire market per 100 inhabitants)(%)	93.7	99.2	109.0
GSM penetration in Italy (% of population)	99.8	99.8	99.8
Internet and Media:			
Page Views Virgilio (millions)	5,267	6,612	7,902
Active User ISP (thousands)	2,227	2,514	3,346
La 7 average audience share (%)	1.8	2.2	2.4
La 7 audience share of December (%)	2.1	2.2	2.6

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

(2) Data excludes internal lines.

(3) Number of contracts. Broadband access contracts in Italy as of December 31, 2002, 2003 and 2004 were 850,000, 2,040,000 and 4,010,000 respectively.

(4) Number of contracts; data includes Teleconomy, Hellò and other business voice offers.

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- (5) Retail traffic consists of traffic from Telecom Italia customers for local calls, long distance national and international calls (including calls to mobile phones).
- (6) Includes total fixed outgoing traffic (including international outgoing traffic and fixed outgoing traffic to the mobile networks).
- (7) Including district and Internet dial-up traffic.
- (8) The foreign lines include those of mobile affiliate AVEA I.H.A.S. (Aria-Is TIM for 2003) and those of T-Mobile CZ. Our proportionate share results in total lines of 42.0 million as of December 31, 2004. The number of foreign lines of AVEA I.H.A.S. includes approximately 2 million from Aycell. TIM International agreed to sell its stake in TIM Hellas and Corporacion Digitel which companies represented 3.7 million subscriber lines. In addition, on March 24, 2005 TIM, through TIM International, finalized with T-Mobile Global Holding the sale of 7.16% of the share capital of CMobil (Dutch holding owning 60.8% of T-Mobile CZ). On May 5, 2005, regulatory authorities in Venezuela decided not to grant the authorization for the sale of TIM International's stake in Corporacion Digitel S.A. to CANTV. Because the decision is subject to administrative and judicial review and TIM International intends to pursue appropriate remedies, at March 31, 2005, TIM treated TIM Hellas and Digitel as discontinued operations. Consequently, as of March 31, 2005, TIM International managed 15.9 million lines, all in Latin America, excluding the lines of affiliated company AVEA. The lines of AVEA rose to 5.2 million as of March 31, 2005, from 4.8 million as of December 31, 2004.
- (9) Including Prepaid Customers' revenues and excluding equipment sales and including non-TIM customer traffic.

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4.1.8 UPDATED TARGETS AND STRATEGY

On April 12, 2005, we announced our targets and established our priorities for the 2005-2007 period.

Significant changes are occurring in wireline and wireless markets which pose new challenges for the Telecom Italia Group, but also offer new opportunities. The demand for telecommunications services is growing, driven by the growth of broadband in our wireline business and by the new services offered in the mobile segment. In particular:

- communications on fixed networks have enriched the supply of traditional voice and data services by adding innovative services made possible by XDSL technology and fiber optics;
- communications on the new-generation mobile networks (GPRS, EDGE and UMTS) now permit mobility not only for voice services but also for data, Internet and media services.

Alongside these recent developments, additional elements of discontinuity in technology and the market are leading towards a progressive reduction in the traditional distinctions between our principal business areas of wireline and mobile.

Some trends in technologies are facilitating interaction between the different networks (fixed and mobile, voice and data) and between the suppliers of telecommunications services and suppliers in adjacent sectors, such as information technology, media and consumer electronics, offering operators the opportunity to develop new services and make the technical management and development of network infrastructures more efficient.

On the demand side, customers increasingly want to use the services made possible by the new technologies seamlessly, regardless of where they are. In particular, business customers require solutions for access to their own intranet and to corporate applications with the fixed or mobile network available at any given moment, and consumers are interested in the creation of multimedia portals with access from both fixed and mobile networks to enjoy digital content (music, film, etc.).

The evolution of the market requires an update of current business models and organizational strategies, an objective that the TIM Acquisition is intended to promote.

To ensure effective governance of the evolution of the post-TIM Acquisition business and organization structure, working groups have been formed to identify specific areas which may offer efficiency gains in activities, processes and products in the fixed and mobile sectors. 1.5 billion of synergies cumulative for the 2005-2007 period have been identified.

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An additional advantage of the TIM Acquisition is a further opportunity to optimize financial structure and cash flow within the Telecom Italia Group by managing Telecom Italia Group debt more efficiently and making better use of financial leverage.

In particular, from a business perspective, the main focus during the 2005-2007 period will be on the following:

Enriched offering: We will seek to expand our offer, primarily in broadband, UMTS and digital terrestrial television (DTT). In broadband we will upgrade transmission capacity, introduce advanced services over IP, new handsets and customer equipment and voice and VAS for businesses. With respect to UMTS, we will continue to roll out our UMTS network, continue to innovate on services, offer new handsets and selectively deploy HSDPA technology. In DTT we intend to extend coverage, promote pay-per-view contents and launch interactive services.

Synergies: We plan to further develop synergies between our fixed and mobile businesses following the TIM Acquisition, particularly with respect to network and IT innovation, VAS innovation, sales networks, customer operations and purchasing.

Focused International Growth: Our international strategy will be focused on selected growth areas, including

- leverage our strong position in the Brazilian market;
- expand selectively in the European broadband market; and
- evaluate integrated investment opportunities in Turkey.

Integration in the Internet Sector: We plan to integrate Tin.it/Virgilio in Wireline in order to develop a more coherent strategy on the ISP and the portal.

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As of January 1, 2005 we are required to apply IAS/IFRS accounting standards to the preparation of our financial statements. See Item 5. Operating and Financial Review and Prospects 5.5 Adoption of International Accounting Standards 5.5.4. Principal Impacts On The 2004 Consolidated Financial Statements Deriving From the Application of IAS/IFRS which describes in some detail the impact of IFRS on our Italian GAAP financial statements. The IFRS information prepared to date is preliminary and liable to amendments and has been prepared on the basis of IAS/IFRS currently in force and following the interpretations currently available. The following data is unaudited.

Based on the application of IFRS, consolidated net financial debt as of December 31, 2004 would increase by 3.3 billion (from 29.5 billion to 32.8 billion).

In the first three months of 2005, net financial indebtedness has increased by approximately 14.0 billion as a result of additional borrowings and the total outflow borne by Telecom Italia for the purchase of TIM shares tendered and accepted in the public tender offer as part of the TIM Acquisition, partially reduced by the conversion of Telecom Italia 1.5% 2001-2010 convertible notes with redemption premium .

We are targeting to reduce our net financial indebtedness at year-end 2007 back in line with net financial debt at year-end 2004 as determined under IAS, through significant cash flow generation combined with the net proceeds from further disposals of non core assets. Such debt reduction nonetheless assumes that over the 2005-2007 period we will maintain our dividends in line with dividends paid for fiscal year 2004 and continue investing in innovation.

Our financial targets for the period 2005-2007 (based on IAS/IFRS) include:

	Objectives of Telecom Italia on a consolidated basis-CAGR(1)
Operating revenues	+4/6%
Operating income	+7/9%
Capital expenditures (cumulative 2005-2007) (in billion)	~14 billion

(1) 2004-2007 Organic growth: excluding change in consolidation area, exchange rate impact and exceptional items.

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

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 would cause our actual results to differ materially from the targets discussed above. See, also, Item 3. Key Information 3.1 Risk Factors . There can be no assurance that we will be able to achieve the financial targets we have established.

Wireline

In Wireline, the principal focus over the past two years has been on broadband and loyalty programs. At the end of 2004, the customer base of broadband accesses was 4,010,000 in the domestic market and 420,000 in the European market (France and Germany). 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, with the focus on obtaining continuing efficiencies.

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);

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- 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 WI FI), but also on innovation in voice and videocommunication services and terminals, equipped with new facilities, similar to mobile phone functions;
- 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 development 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;
- full enhancement of the potential of the GPRS/EDGE/UMTS network integration; and
- consolidating GSM leadership in Brazil and enhancement of the competitive position.

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

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- 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;
- value enhancement of subsidiaries and associates through the plug and play strategy to share resources and know-how via a centralized support of local networks in different countries;
- development of synergies between fixed and mobile services;
- 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.

Telecom Italia Media

Following the sale of the Internet activities to Telecom Italia, Telecom Italia Media will refocus from a diversified media holding to a focused media company with valuable brand and strong positioning in the Italian TV market, exploiting selected investment opportunities in TV and related media.

In particular, the strategy to be implemented over the 2005-2007 period includes:

- La7: continue improvements in free to air performance;

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- MTV: confirm leadership, high growth rates, profitability and cash generation;
- Digital Terrestrial Television: invest to gain momentum in the growing DTT market leveraging on brand and asset portfolio.

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

4.1.9 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 May 23, 2005.

(1) Starting from January 24, 2005, the Central Function Brand Enrichment corresponds to Progetto Italia S.p.A..

(2) Consortium company which carries out Internal Auditing activities in the Telecom Italia Group.

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

Reorganization

The Telecom Italia Group continued to reorganize its operations during 2004. As a result, the following organizational changes took place:

- since February 23, 2004, the International Legal Affairs Function, previously under Corporate and Legal Affairs, reports 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;

- on March 1, 2004, the Latin America Operations Function was disbanded. This Function, set up in 2002, reported to the head of the Mobile Business Unit for mobile telecommunications and to the CEO

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Carlo Buora for wireline telecommunications and for the global coordination of all the activities of the Group in Latin America. Telecom Italia Latam has taken over the new role of the delocalized Corporate Function in Latin America. 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 was appointed as Chairman of Telecom Italia Latam;
- on December 10, 2004, with the agreement of the Telecom Italia Group, Mauro Sentinelli resigned as TIM's General Manager. Mr. Sentinelli, who is also Deputy Chairman of the GSM Association, will continue to act as an advisor to the Chairman of Telecom Italia on the evolution of technological platforms. On December 22, 2004, Mauro Sentinelli also resigned as a director of TIM;
- since January 2005 Marco Forneris assumed responsibility for the Information Technology Group which responsibility is to develop strategies and plans for the Information Technology Group in accordance with the IT Governance Committee guidelines, to define Information Technology Group architectures, to coordinate development programs and system integration of IT solutions for the Business Units of the Telecom Italia Group;
- since January 2005 the Central Function Brand Enrichment corresponds to Progetto Italia S.p.A. which ensures with the Communication and Image Function coordination the enhancement of the Telecom Italia Group through definition and development of initiatives in the charity, culture, education and sport sphere;
- on February 15, 2005 Giovanni Ferrario was appointed C.E.O. of Olivetti Tecnost.

The Telecom Italia Group Committees have been revised as follows:

- **Management Committee**, which aims to coordinate the Telecom Italia Group's activities and ensure unitariness in the development and implementation of business strategies;
- **Business Reviews**, which monitors the results of each Business Unit, analyzes forecasts and operational progress reports and decides on the resulting action plans;
- **Investments Committee**, which approves investments exceeding specific authorized limits;
- **Steering Committee Telecom 2007**, which guides and approves the Telecom Italia Group's initiatives in terms of innovation, development and efficiency, and also controls their progress, for purposes of ensuring the effective implementation of the TIM Acquisition;
- **Steering Committee**, which implements Project 404, aimed at ensuring the timely completion of the preliminary steps necessary, at a Telecom Italia Group level, for Telecom Italia to fulfill the disclosure requirements on internal control issues, as set forth in Section 404 of the Sarbanes-Oxley Act of 2002;

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- **Purchases Committee**, which promotes coordination of the Telecom Italia Group's purchasing processes, monitoring their performance and maximizing synergies among the Business Units/Companies;
- **IT Governance Committee**, which defines the guidelines for the information technology strategies of the Telecom Italia Group, directs the relative plans and monitors their progress;
- **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 whose purpose is to ensure a unitary vision of the initiatives developed by the Business Units, to leverage the contents present in the Telecom Italia Group's plans and packages and to define a synergic approach with outside suppliers;
- **Technological Committee**, which guarantees integrated safeguarding of the innovation and technological development processes;
- **IT Security Committee**, which ensures integrated security in the management of the information and computer security of the Telecom Italia Group;

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- **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 guarantees overall consistency of Telecom Italia Group s activities in Latin America, ensuring unitariness in the development and implementation of business strategies.

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The Wireline Business Unit operates on a national level as the consolidated market leader in wireline telephone and data services for final retail customers and wholesale providers. On an international level, Wireline develops fiber optic networks for wholesale customers (mainly in Europe and South America) and provides access and innovative Broadband service packages in key European countries.

Aggressive market competition continued during 2004. This was most prominent in the case of national traffic, and was countered with new plans offered as part of actions to retain customers.

The Wireline Business Unit accounted for gross operating revenues of 17,571 million in 2004, 17,216 million in 2003 and 17,047 million in 2002. The 2004 gross operating revenues recorded positive growth of about 2.1% which is one of the most important goals of the Wireline Business Unit's strategy.

The organizational structure of the Wireline Business Unit as of December 31, 2004 was as follows:

Telecom Italia Wireline	WIRELINE National Subsidiaries	International Subsidiaries
Wireline TLC services:	Loquendo S.p.A.	BBNED group
	Path.Net S.p.A.	Latin American Nautilus group
• Retail Telephone	Telecontact Center S.p.A.	Mediterranean Nautilus group
		Med-1 group
• Retail Internet		Telecom Italia Deutschland Holding GmbH
• Data Business		HanseNet Telekommunikation GmbH
• V.A.S. Phone and Data		

- National Wholesale

Telecom Italia Sparkle group

- Telecom Italia Sparkle S.p.A.

Intelcom San Marino S.p.A.

Telefonia Mobile Sammarinese S.p.A.

Pan European Backbone (includes Telecom Italia France)

Telecom Italia Sparkle of North America Inc.

V **KEY ISSUES IN ITALY**

- The Wireline Business Unit is focused on switching its customers from traditional to innovative technologies to enlarge IP services and applications. The Wireline Business Unit intends to expand its large penetration in the broadband 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 4,010,000 broadband points of access sold to the retail and the wholesale market at the end of 2004 (2,040,000, at December 31, 2003), of which 3,115,000 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 new services, based on innovative use of its fixed network, such as video communication and SMS (Short Message Service) for fixed telephones. In particular, commercial efforts have been made to support innovative telephones sales, e.g. *Aladino* (with functions and design very close to a mobile last generation phone) and video communication terminals.
- 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 computer, keeping in touch with the network

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(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.

- In the voice area the key issue is to continue developing voice offers (Teleconomy, Hellò and other business customized offers) to support loyalty and retention and win back customers which have moved to other service providers.

V SUBSCRIBERS IN ITALY

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

	As of December 31,				
	2000	2001	2002	2003	2004
Subscriber fixed-lines at period-end (thousands)(1)	27,153	27,353	27,142	26,596	25,957
Subscriber fixed-line growth (decline) per annum (%) (2)	2.5	0.7	(0.8)	(2.0)	(2.4)
ISDN equivalent lines at period-end (thousands)(3)	4,584	5,403	5,756	6,027	5,805
Broadband Access (ADSL + XDSL) (thousands)(4)		390	850	2,040	4,010
Voice Offers (thousands)(5)		4,094	5,224	5,547	5,883

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

(2) For each of the years ended December 31, the percentage growth (decline) figure represents growth (decline) 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, 2004, the Wireline Business Unit had approximately 26.0 million fixed subscriber lines, including approximately 17.7 million residential lines (including multiple lines for ISDN), approximately 8.0 million business lines (including multiple lines for ISDN), and approximately 230,000 public telephones lines (including ISDN equivalent lines).

As of December 31, 2004, the Wireline Business Unit had approximately 5.8 million ISDN equivalent lines. The number of subscribers is expected to slowly decline as marketing is focused on ADSL lines which provide greater speed on the Internet. This is evidenced by significant growth in broadband access.

As of December 31, 2004, 57.4% 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 4.0 public telephones for every 1,000 inhabitants. During 2004, ISDN technology was introduced to approximately 54.0% of public telephones in order to support the launch of innovative services (approximately 124,500 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).

V **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 10,267 million in 2004, a decrease of 0.6% compared to 2003 (10,334 million in 2003). The Wireline Business Unit successfully limited the intense competitive impact in the retail segment during 2004. Traffic packages (voice offers), loyalty and retention schemes strategies resulted in limited revenue losses while market share on traffic volumes was stable (market share on voice traffic: 73.1% at December 31, 2004 against 73.2% at December 31, 2003).

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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 2004, the Wireline Business Unit continued focusing its efforts on growing its ADSL mass market base. In particular, on March 15, 2004, Telecom Italia, in keeping with its commitment to develop innovative broadband services, launched the video on demand service for computers through the Rosso Alice portal. This portal, which is organized into six areas (films, sport, music, videoclips, games, information and video-community) offers the service on demand to all Internet users with an ADSL connection. Alice customers can purchase the content through a credit card or by direct debit to their phone bill.

Revenues grew significantly in 2004, to 987 million, an increase of 34.1% over 2003 (736 million in 2003). Revenues from ADSL were approximately 590 million increasing strongly by 108.5% over 2003 (283 million in 2003) although revenues from Internet dial-up traffic continued to decrease due to migration to Internet connections from broadband access (from 443 million in 2003 to 384 million in 2004, a decrease of 13.3%).

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 2004, the Wireline Business Unit continued supporting offers for the data transmission networks and Internet access, including:

- WI FI service: at December 31, 2004 the number of locations is approximately 1,000 in Italy and approximately 17,000 abroad due to roaming agreements with important international operators; and

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- new wireless solutions for Interbusiness and Hyperway, based on CISCO innovative technologies.

Revenues from data services (including leased lines data equipment rental and assurance) amounted to 1,539 million in 2004 and increased by 2.0% over 2003 (1,510 million in 2003). 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 20% in 2004 compared to 2003 (624 million in 2004 and 520 million in 2003) while revenues from data equipment increased by 21.1% to 298 million in 2004 (246 million in 2003).

Revenues from traditional data services (data transmission using data packet technology) decreased by 18.7% from 337 million in 2003 to 274 million in 2004 mainly due to customer migration to broadband services and repricing.

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.

As of December 31, 2004, there were approximately 200,000 (in points of entry of data network) lines leased to business customers (approximately 274,000 at December 31, 2003) and approximately 82,000 digital leased lines (approximately 107,000 at December 31, 2003).

Revenues from leased lines were 343 million in 2004 compared to 407 million in 2003, a decrease of 15.7%.

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Retail VAS include new services for all Wireline customers such as web services, outsourcing and security for business customers and 4* (easy access to a large number of services), SMS (from fixed telephones), Memotel (centralized mail box) and Chi è (identification of calling number) for residential customers. Revenues from VAS were 1,070 million in 2004, a reduction of approximately 60 million or 5.3% compared to 2003. The reduction is attributable to new pricing regulation adopted by regulatory authorities for certain premium services partly offset by significant growth in innovative VAS (web services, 4*, etc.) which increased by 23.0% from 647 million in 2003 to 796 million in 2004.

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 3,329 million in 2004 an increase of 1.9% compared to 2003 (3,268 million in 2003). Domestic wholesale and International wholesale services increased respectively by 6 million and by 55 million compared to 2003. In Domestic wholesale services, revenues from Data offers, especially broadband, offset price reductions in leased lines to other operators. In International wholesale services, traffic volumes carried to other operators drove revenues growth.

V TRAFFIC AND TARIFFS

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

	Year ended December 31,				
	2000	2001	2002	2003	2004
Wireline total traffic (Retail and Wholesale) (billions of minutes)	171.3	209.8	214.9	226.6	216.8
<i>of which:</i>					
<i>National(1)</i>	163.8	201.1	204.7	215.2	203.9
<i>International(2)</i>	7.5	8.7	10.2	11.4	12.9
Retail Traffic:					
Average minutes of use per fixed line subscriber during period(3)	4,722	4,739	4,292	4,127	3,935
<i>of which:</i>					
<i>Local traffic during period (in average minutes)(4)</i>	3,621	3,575	3,198	2,971	2,749
<i>Long distance traffic during period (in average minutes)</i>	1,101	1,164	1,094	1,156	1,186

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- (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 the mobile networks).
- (4) Data 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.

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.

Residential offers. Offers introduced in 2004 for retail customers included a number of new services, such as video calling, as well as local or long-distance voice calls at a price of six euro cents per minute. Also, the pricing

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offer with regard to Teleconomy/Hello was enlarged with the launch of Teleconomy Quando Vuoi, which, by the payment of a subscribers' fee of 5.58 per month (including VAT), allows the customer to make unlimited national traffic calls inside the time band chosen by the customer. Outside of the specific time bands, other prices apply. In addition, the Welcome Home offer was launched, specifically for customers with high volumes of international traffic, and the monthly fee is equal to 0.432 (including VAT).

Business offers. Offers introduced in 2004 included the Programma Business offer which was enlarged, with 3 new price lists addressed to customers with high volumes of traffic. The Teleconomy Aziende Quando Vuoi offer was introduced for business customers. Such offer is the same as that for residential customers, but with a monthly charge of 6.50 (excluding VAT).

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.

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 (Retail Price Index) + 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 $RPI-6\%$.

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

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In accordance with the price cap mechanism, during 2004 Telecom Italia implemented the following tariff changes:

- an increase of approximately 55 million in access prices equivalent to an increase of 1.2% (40 million for Business customers, representing an increase of 2.5%);
- a reduction of fixed to mobile traffic tariffs with consequent reduction of Retention (that is the amount due to Telecom Italia) equal to approximately 17 million (a 3.5% reduction).

During 2004, certain adjustments in International Traffic tariffs were implemented. These changes have had a limited impact on traffic revenues (estimated at approximately 1.4 million in 12 months).

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,				
	2000	2001	2002	2003	2004
Total outgoing traffic (millions of minutes)	2,706	3,015	3,405	3,682	3,990
Growth in outgoing traffic (%) ⁽¹⁾	13.2	11.4	13.0	8.1	8.4
Total incoming traffic (millions of minutes)	3,415	3,845	3,842	3,299	3,445
Growth in incoming traffic (%) ⁽¹⁾	(0.1)	12.6	(0.1)	(14.1)	4.4
Total international transit traffic (millions of minutes)	1,310	1,825	2,995	4,382	5,452
Growth in international transit traffic (%) ⁽¹⁾	52.9	39.3	64.1	46.3	24.4

(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 2000 to 2004 was mainly impacted by macroeconomic factors such as growth in foreign demand, import/export activities, foreigners and new subscribers.

During 2004 outgoing international traffic increased by 8.4% compared to 2003. The 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 46% of toll minutes in 2004.

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

The traffic incoming on the mobile network increased by 196 million minutes compared to 2003 (+16.1%) while the traffic incoming, or deemed to be incoming, on the fixed network decreased by 50 million minutes compared to 2003 (-2.4%).

In 2004 wholesale international activities were focused on managing international transit traffic that resulted in volume increases of 1,070 million minutes (an increase of 24.4%) compared to the previous year. This performance was due to the acquisition of new wholesale customers through 57 new interconnections (29 of which in Voice Over IP), the reduction of the costs through new techniques of transportation as VOIP (863 millions of minutes), and finally to new hubbing strategies in Africa and Middle East.

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.

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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. From the 2003 Reference Offer (RO), the market has gained 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 Retail Price Index (RPI) X:

- SGU (Local exchange interconnection and interconnection kit and circuits) = RPI 8%;
- SGT (Single transit interconnection) = RPI 6%;
- 2SGT (Double transit interconnection) and international transit by SGT = RPI 3.75%;
- Ancillary services (e.g. number portability charging, Carrier Pre-Selection (CPS) charging) = RPI RPI;
- Local Loop Unbundling (LLU) = As of January 1, 2005, the National Regulatory Authority has not defined the caps related to this service.

With respect to LLU, the National Regulatory Authority in the order 3/03/CIR 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 (Plain Ordinary Telephone Service) line and 11.10 per month for ADSL line. Regarding implementation, the Italian LLU market is one of the fastest growing LLU markets in Europe with almost 760,000 fully unbundled lines on December 31, 2004 (Italy is second after Germany where LLU started about two years before), representing an increase of about 250,000 lines compared with the end of 2003.

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 Other Licensed Operators (OLOs). In 2004, the OLOs have begun the use of lines in shared access and 23,000 lines were activated at the end of the year.

In April 2004, the National Regulatory Authority approved, subject to certain technical and economic amendments, the 2004 RO originally submitted by Telecom Italia in October 2003. Telecom Italia's 2004 RO includes the conditions for Flat-Rate Internet

Access Call Origination (FRIACO) service, partial circuits provisions, shared access and sub-loop unbundling, thus enabling a competitive development of Internet access and broadband services.

- FRIACO: Telecom Italia 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: Telecom Italia 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. Telecom Italia, 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.

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Since April 2002, Internet Service Providers (ISPs) (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 regulate the manner in which customers can request deactivation of the CPS service. The National Regulatory Authority determined that a client can send his deactivation request both to Telecom Italia and to the preselected OLO.

On December 12, 2004, the National Regulatory Authority published:

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

According to the report, the Auditors in charge of preparing the report found that, for 2001, the Regulatory Accounting data issued by Telecom Italia have as a whole been issued in conformity with the appropriate methodological criteria required by law.

In 2004 Telecom Italia presented to the National Regulatory Authority the Accounting Separation and Regulatory Accounting for Fiscal Years 2002 and 2003.

In 2004, the Telecom Italia Group set up interconnections with the networks of five additional operators, making a total of 55 operators with operating interconnection agreements at December 31, 2004.

During 2004, the following contracts were also signed or renewed:

- five new interconnection agreements;
- six additional reverse agreements, terminating calls on the network of another operator;
- 60 agreements to supply high-speed access services using xDSL technology;

- seven carrier preselection contracts, two district carrier selection agreement and six number portability agreements;
- two contracts for shared access service on the local network; and
- 34 contracts to supply Digital Data Circuits or Partial Circuits.

V **FIXED NETWORK**

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 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, 2004 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	430,000 kilometers-line
Fiber optic carrier network	3.24 million kilometers-line
Direct dialing circuits	3.9 million
Network for direct digital circuits (PARD)	435,000 access points with speed up to 2 Mbit/s
Network for direct analog circuits (PARD)	93,000 access points
Frame Relay Accesses	85,000 gates at 2Mbit/s
PoP main data networks	32

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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 10 Gbit/s. Work on the development of the national network (Long distance) which, by use of the latest generation of SDH technologies and the optical DWDM technology (Dense Wavelength Division Multiplexing) constitutes the basis for the transport network with a high transmission capacity capable of covering the entire Italian territory, continued during 2004. In order to reduce the number of fibers, DWDM systems have been used to multiply by a factor of 12 up to 40 the available optical fiber band and the current transmission capacity, thus increasing the transport capacity of the connections. In November 2002 Wireline introduced a new generation of Optical Digital Cross Connect on the domestic wireline transmission backbone in order to progress with the transition from a national network based on a SDH rings architecture, towards the new generation of meshed ASTN (Automatically Switched Transport Network) optical backbone which started in 2003, continued during 2004 connecting over 28 cities (all the major cities of Italy) and will continue through 2006 (adding a further 38 nodes). By using the ASTN approach it is possible to build a multiservice platform with a high level of integration with the IP network.

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

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

To reduce costs and improve efficiency, Telecom Italia Group, has undertaken, starting in 2001, and will continue to implement, an extensive program to reengineer its network operation and maintenance organization, to permit a more effective use of human resources.

Starting from 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 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 2004, commercial services with access to ADSL technology for business customers and Internet Service

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Providers had been extended to 2,617 cities (approximately 2,100 at the end of 2003). 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 2004, the local exchange areas covered by ADSL technology numbered 3,750 (3,000 at the end of 2003).

Fiber optic Cables. At December 31, 2004, the Telecom Italia Group had installed approximately 3.7 million kilometers of optical fiber for access and transfers, of which approximately 1.2 million kilometers were installed on long distance fixed-lines. Fiber optic cables significantly increase the capacity of the network and 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 2004, 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 over 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, 2004, approximately 435,000 direct digital line access points and approximately 93,000 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 NNIA (Network Node Interface Agreements).

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

- **PEB** (Pan European Backbone). A fiber optic network 2 fiber pairs, 400 Gbit/s each laid in the main industrialized European countries: Italy, France, U.K., Belgium, Germany, Switzerland, Austria and Spain with a total length of 12,000 km. The cross-border services available for wholesale customers are: Managed Bandwidth, IP Connectivity, International Private Leased Circuit, Global Voice Services, GRX (GPRS Roaming eXchange for Mobile Operator);

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- **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;
- **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 290 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 softswitches, 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 (17 POPs), in the USA (4 POPs), in the Mediterranean basin (5 POPs), in South America (9 POPs) and in Asia (1 POP).

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The POPs in the USA belong to Telecom Italia Sparkle of North America (TISNA), a wholly-owned subsidiary of Telecom Italia, that has implemented POPs in Newark (NJ), New York, Miami and Ashburn to offer Voice and IP/Data services with a network 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, IP and managed bandwidth services in South America and managed bandwidth services in the Mediterranean.

During 2004, there were major projects related to:

- development of new features and capacity upgrade of the switching devices for the international voice services;
- new POP in Singapore for voice services;
- upgrade of the transmission capacity of the Pan European and transatlantic backbone;
- new POP in Hamburg and Cairo dedicated to IP&Data services; and
- new devices in the POPs of Santiago, Buenos Aires, Lima and Sao Paolo to offer IP services.

In Italy, the class 4 softswitches are replacing the legacy switching exchanges, in order to improve quality of service and decrease operational costs. The migration of the circuits, connecting more than 200 carriers, will be completed by 2005.

On March 2004 Telecom Italia Group, together with a consortium of 15 other international telecom operators, signed in Dubai the Construction and Maintenance Agreement of the new submarine cable system, South East Asia Middle East Western Europe 4 (SEA-ME-WE 4) cable system. The system will span some 20,000 km across the world with an ultimate capacity of 1,300 Gbit/s, terminating in more than 10 countries including Singapore, Malaysia, Thailand, Bangladesh, India, Sri Lanka, Pakistan, United Arab Emirates, Saudi Arabia, Egypt, Italy, Tunisia, Algeria and France. This SEA-ME-WE 4 cable system is the 4th in the series of the SEA-ME-WE cable systems and its construction is expected to be completed by 2005.

Retail International Network

Telecom Italia, with the International Broadband plan, has created an innovative offer of broadband access and services in a number of large metropolitan areas in Europe. The plan, started in 2003, currently includes France and Germany through the controlled companies Telecom Italia France and HanseNet.

France

In 2004 Telecom Italia France increased the portfolio and the coverage of broadband service on Local Loop Unbundling (LLU) in the area of the Ile de France (Paris) and in the cities of Nantes, Strasbourg, Lille and Bordeaux. The activities for the closing of the national rings are running, that concurs to the protection of the traffic and increases the asset of Telecom Italia France.

Other main activities carried out during 2004 have been:

- the deployment of POPs in the cities of Paris (2 POPs), Lyon, Marseille (also serving Aix-en-Provence), Nice, Nantes, Strasbourg, Lille;
- the implementation of local loop unbundling in 209 central offices;
- the deployment of fiber optic connections among POPs, through Telecom Italia's Pan European Backbone, and between POPs and 176 exchanges for a total of 1,448 Km;
- the increase of the Backbone Infrastructure up to 2,396 km of fibre optic in IRU and 1,300 km at 2.5 Gbit/s (PEB); and
- 577 interconnection circuits with France Telecom (2Mbit/s).

In 2004, a new offer of VAS services (4* - easy access to a large number of services) and the Telecom Italia Internet portal RossoAlice.it were developed.

Germany

In 2004 it was decided to extend the broadband services beyond the Hamburg area (including Lubeck), to other major cities in Germany (Munich, Berlin, Stuttgart, Frankfurt).

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The main activities carried out during 2004 included:

- 3 POPs in Hamburg and deployment of 4 new POPs in the cities of Berlin, Munich, Stuttgart and Frankfurt;
- preparation of 251 new central offices to be equipped for local loop unbundling within the four mentioned cities;
- implementation of a Backbone Infrastructure up to 2.150 km fibre optic in IRU; and
- 600 interconnection circuits with Deutsche Telekom (2Mbit/s).

V EVENTS SUBSEQUENT TO DECEMBER 31, 2004

- On January 19, 2005 the National Regulatory Agency approved new Telecom Italia rate charges affecting local calls. The new charges, with effect from January 23, 2005, have increased the price of the answering charge for local calls but have reduced the price per minute of the duration of local calls.
- On January 26, 2005 Telecom Italia signed a protocol agreement with the Consumer Associations which establishes new modes of operation for handling complaints about traffic generated from the abuse of non-geographic area code 709 numbers for Internet dial-up by third parties with consequent high charges for customers. In addition, Telecom Italia decided to cancel the amounts owed for such traffic prior to September 1, 2003 in the case of residential customers who lodged a complaint as prescribed by the conditions in the phone contract and have reported the abuse to or commenced legal proceedings with the competent authorities.
- On February 1, 2005 Telecom Italia doubled the speed of broadband connections to 640 Kb/s both for residential customers with ADSL flat-rate plans and business customers. As a result, these customers received a connection upgrade to 1.2 Megabit/s for receiving and to 256 Kb/s for transmitting, without having to request an upgrade or pay any extra charge.
- Starting from March 31, 2005 Telecom Italia raised Internet connection speeds to 4Mb per second in its latest flat-rate package (Alice 4 Mega). Eighty-five percent of currently available ADSL connections will be able to take advantage of this superfast link.

4.2.2 MOBILE

The Mobile Business Unit (TIM group) operates in the sector of national and international mobile telecommunications. Its international operations are concentrated in Latin America and in the Mediterranean Basin.

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The Mobile Business Unit accounted for gross operating revenues of 12,900 million in 2004, 11,782 million in 2003 and 10,867 million in 2002.

As of December 31, 2004, the Business Unit was organized as follows:

National Subsidiaries	Mobile	TIM International N.V.	Major Affiliated
	Major International Subsidiaries	Other Subsidiaries	
	Mobile South America		
TIM Telecom Italia Mobile S.p.A.	TIM Brasil group:	TIM Hellas	AVEA I.H.A.S. (Turkey)
		Telecommunications S.A. (Greece) (3)	
TIM Italia S.p.A. (1)	<ul style="list-style-type: none"> • TIM Participações group (Brazil) • TIM Celular S.A. (Brazil) <li style="padding-left: 20px;">Maxitel S.A. (Brazil) • CRC Ltda (formerly Starcel Ltda) (Brazil) 		
	TIM Perù S.A.C.		
	Corporacion Digitel C.A. (Venezuela) (2)		
	Blah! S.A. (formerly TIMNet.com S.A. Brazil)		

-
- (1) Not operational as of December 31, 2004. Company receiving domestic mobile assets spun-off by TIM as a preliminary step to completion of the TIM Acquisition.
- (2) On November 5, 2004 a memorandum of understanding was signed to sell the equity interest held in Corporacion Digitel. On May 5, 2005, regulatory authorities in Venezuela decided not to grant authorization for the proposed sale. The decision is subject to administrative and judicial review and TIM International intends to pursue appropriate remedies.
- (3) On April 3, 2005 an agreement was signed to sell the equity interest held in TIM Hellas subject to satisfaction of certain conditions.

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Among the large mobile telecommunications operators in Europe at the end of 2004 TIM had the largest number of lines in its domestic market (source: Mobile Communication magazine) and has been the fastest growing area of the Telecom Italia Group's business for many years. Line growth, which has slowed down considerably in recent years, was 6% in 2002, 3% in 2003 and 1% in 2004. Gross operating revenues from TIM totaled 9,943 million, 9,469 million, 9,022 million (8,915 million net of Blu merger effect) in 2004, 2003 and 2002, respectively.

TIM is expected to be merged with Telecom Italia by the end of June 2005 as the final step in the TIM Acquisition. Following completion of the TIM Acquisition, TIM Italia S.p.A. and TIM International N.V. will become direct wholly owned subsidiaries of Telecom Italia.

V SERVICES ITALY

TIM primarily offers digital mobile services as well as its legacy analog service which is being phased out. The GSM digital service, which commenced operations in April 1995, uses digital technology and is the standard throughout Europe. GSM generally provides higher quality transmission than analog service and may be used by customers to make and receive mobile calls throughout Europe and certain other countries. During 2004, TIM launched its third generation services (based on UMTS technology) and the advanced second generation services through the EDGE technology. These technologies are interoperable and permit seamless usage of dual mode handsets linked to UMTS and GSM/EDGE networks. As of March 31, 2005, roaming agreements have been reached with 423 operators in over 187 countries, allowing customers to make and receive calls abroad. See 4.2.2 Mobile Mobile Tariffs below. The analog service is based on the TACS 900 standard and began operation in 1990. See 4.2.2 Mobile Cellular Network .

V CUSTOMERS AND LINES

The penetration of mobile telecommunications service in Italy is above the Western European average at approximately 109 lines per 100 inhabitants at the end of 2004 and growth rates have been substantially higher than the European average. This compares to a penetration rate of 94 and 99 lines per 100 inhabitants at the end of 2002 and 2003, respectively. The increase is due to innovative services and an increase in customers with multiple lines and the number of operators. TIM's customer base consists of GSM subscribers and customers holding GSM TIM Cards (GSM Prepaid Customers) as well as TACS subscribers and customers holding TACS prepaid services (TACS Prepaid Customers and together with GSM Prepaid Customers, Prepaid Customers). TIM is in the process of closing down its TACS service and is transitioning its customers to its GSM and UMTS network. In 2004, TIM had an 8.2% market share of net additional GSM and UMTS lines, corresponding to 0.5 million net lines, compared to 1.5 million for Vodafone Omnitel, 2.2 million for Wind and the remaining 2.3 million attributable to H3G(3).

It should be noted that TIM's subscriber numbers do not include 688,000 silent lines. Silent lines are prepaid lines which are no longer active but have not yet been disconnected. As the Italian market is characterized by a high penetration of prepaid cards, customers will acquire multiple lines to take advantage of special commercial offers but with the intention of not maintaining the lines once the offer expires. TIM excludes these lines in order to ensure greater consistency between the number of lines managed and business development. TIM is the only operator in Italy that reports the customer base figure net of those lines.

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At December 31, 2004, the number of lines for TIM s GSM, UMTS and TACS mobile service was approximately 26.3 million (of which 25.8 million were GSM lines, 0.2 million were UMTS lines consisting of 2.8 million of GSM subscribers and 23.0 million of GSM Prepaid lines, and 0.2 million of UMTS Prepaid lines). As of March 31, 2005, TIM s customer base remained essentially unchanged at 26.2 million lines.

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

	Year ended December 31,				
	2000	2001	2002	2003	2004
	(%)				
TIM Italian geographic coverage					
TACS	83	83	83	83	83
GSM	92	94	94	94	94
TIM Italian population coverage					
TACS	98	98	98	98	98
GSM	100	100	100	100	100

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The table below sets forth, for the periods indicated, selected customer data for TIM's domestic business.

	Year ended December 31,				
	2000	2001	2002	2003	2004
	(number of customers in thousands)				
Lines at period end(1)	21,601	23,946	25,302	26,076	26,259
TACS subscribers	495	304	180	95	52
TACS prepaid lines	1,950	1,430	815	480	172
GSM/UMTS subscribers(2)	2,485	2,538	2,685	2,595	2,809
GSM/UMTS TIM Prepaid Lines(3)	16,671	19,674	21,622	22,906	23,226
	(in %)				
Customer growth	16.6	10.9	5.7	3.1	0.7
Churn(4)	15.7	15.6	18.0	13.2	13.2
TIM penetration(5)	37.5	41.6	43.9	45.3	45.5
Cellular market penetration(6)	73.3	89.0	93.7	99.2	109.0
	(in euro)(6)				
Average revenue per line per month(7)	30.5	29.1	28.8	29.1	30.0

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

(2) Commenced GSM services in April 1995. Commenced UMTS services in 2004.

(3) At December 31, 2004 included 195,000 UMTS prepaid lines.

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

(5) TIM customers per 100 inhabitants.

(6) Customers per 100 inhabitants for the entire market.

(7) Including Prepaid Card revenues, non-TIM customer traffic revenues and excluding equipment sales.

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

customers. Approximately 89.1% of TIM's lines at December 31, 2004, are prepaid. It should be noted that TIM's figures do not include 688,000 silent lines in order to ensure greater consistency between the number of lines managed and business development. In addition, TIM is the only operator in Italy that reports the customer base figure net of those lines.

V UMTS LICENSE

The Italian government awarded five UMTS (third generation mobile communication system) licenses in Italy in November 2000. TIM, together with Omnitel S.p.A. (now Vodafone Omnitel N.V.), WIND S.p.A., Andala S.p.A. (now H3G S.p.A.) and IPSE S.p.A., were awarded licenses to provide third-generation mobile services. TIM committed to pay 2,417 million for its license, with approximately 117 million, 117 million, 117 million and 2,066 million having been paid in December 2003, November 2002, November 2001 and December 2000, respectively. The licenses are valid for 20 years starting January 1, 2002. In 2001, TIM began an experimental UMTS service in its service center in Padua, and a gradual roll-out of the UMTS network has begun. During 2004 TIM launched its third generation services with a fuller development of the customer base expected in 2005.

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

The table below sets forth, for the periods indicated, selected traffic data for TIM's business.

	Year ended December 31,				
	2000	2001	2002	2003	2004
	(millions of minutes)				
Total outgoing traffic per month	1,569	1,795	1,960	2,090	2,211
Total incoming and outgoing traffic per month	2,479(1)	2,815(2)	3,036(3)	3,202(4)	3,435(5)
	(% of total)				
Of which:					
TACS(6)	10.3	5.4	3.0	2.0	0.9
GSM/UMTS(6)	89.7	94.6	97.0	98.0	99.1

(1) Includes domestic mobile incoming and outgoing traffic (90.4% of total mobile traffic in 2000), international traffic (2.9% in 2000) and roaming traffic (6.7% in 2000). These data include fixed outgoing traffic to the mobile network.

(2) Includes domestic mobile incoming and outgoing traffic (92.8% of total mobile traffic in 2001 compared to 90.4% in 2000), international traffic (2.7% in 2001) and roaming traffic (4.5% in 2001). These data include fixed outgoing traffic to the mobile network.

(3) Includes domestic mobile incoming and outgoing traffic (94.5% of total mobile traffic in 2002 compared to 92.8% in 2001), international traffic (2.3% in 2002) and roaming traffic (3.2% in 2002). These data include fixed outgoing traffic to the mobile network.

((4) Includes domestic mobile incoming and outgoing traffic (95.5% of total mobile traffic in 2003), international traffic (1.9% in 2003 compared to 2.3% in 2002) and roaming traffic (2.6% in 2003). These data include fixed outgoing traffic to the mobile network.

(5) Includes domestic mobile incoming and outgoing traffic (93.8% of total mobile traffic in 2004), international traffic (2.2% in 2004) and roaming traffic (4.0% in 2004). These data include fixed outgoing traffic to the mobile network.

(6) Includes traffic from Prepaid Customers.

V MOBILE TARIFFS

TIM's mobile customers (other than Prepaid Customers) are charged a one-time connection fee, a monthly basic charge and traffic fees for calls, as well as a monthly government tax. Prepaid Customers are charged an initial connection fee of 20 for the GSM TIM Card and TACS prepaid service and are required to pay a fee ranging from 5 to 1 to the dealer for each recharge, according to the cost of each recharge. No other connection or subscription fees or taxes are payable by Prepaid Customers. Mobile customers (including Prepaid Customers) must purchase their own mobile telephone handsets. TIM does not subsidize the cost of mobile telephone handsets to its customers and does not intend to do so in the foreseeable future. In 2004, approximately 72% of revenues from TIM mobile services (net of access charge) were derived from traffic charges, 6% from sales and rental of equipment, 13% from VAS and 9% were miscellaneous revenues (subscription and connection fees).

TIM offers its customers a variety of different pricing packages which are tailored to address different usage patterns. Such packages include offerings to TIM's GSM customers of free minutes packages which are available in various options. TIM also offers packages such as, TIM Menù, a dedicated TACS and GSM pre-paid card. The customer can choose a rate suited to his or her own needs, combining the various items on a menu. The objective is to simplify the service offer and at the same time make them more flexible.

TIM enhanced its voice and VAS services during 2004 in order to stimulate usage and traffic among TIM customers and increase customer loyalty. Some of the new services and offers are:

- SOS ricarica : The service allows customers to make calls even with zero credit when it is not possible to recharge the phone immediately, by calling the free number 4916, which grants 2 credit for immediate use. The next time the phone is recharged, 3 is deducted from the total (inclusive of the 1 charge to cover the administrative costs of the service);
- MAXXI TIM Messaggi : The package, directed at prepaid customers, for the sum of 10, allows users to send 400 SMS and 100 MMS within 30 days. The offer is automatically renewed for another 30 days if the remaining credit is at least 13;
- Agreement with 3 : The agreement signed with 3 extends the sphere of commercial collaboration and redefines agreements with regard to roaming, sharing sites and interconnection. The agreement also establishes the sharing of the jointly owned broadcasting rights, via cell phones, of sporting events involving the Serie A TIM and Serie B TIM football teams;

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- **MAXXI TIM Parole** : This is a plan allowing customers to acquire large packages of minutes at highly advantageous prices continuously throughout the year, and the option of choosing the solution best suited to their needs from the many combinations available;
- **Launch of EDGE and TIM TURBO** : With effect from April 2004, TIM (the first company to do so in Italy) launched EDGE, the Broadband mobile network for high-speed data transmission, a service which complements the UMTS service. TIM customers are able to use the new line of dual mode TIM TURBO phones which can use both the EDGE and UMTS networks, allowing the highest-quality services. At the end of May, TIM launched a new line of third-generation services, marking the commercial launch of the combined Edge-UMTS network for TIM customers. In November, the first dual mode EDGE/UMTS handset was available on the Italian market;
- **FreeMove brand**: On March 29, 2004 the members of the Alliance (Orange, Telefonica Moviles, TIM and T-Mobile) presented the new brand FreeMove, illustrating the first tangible results of the Alliance. These include the conclusion of preferential supply agreements with Siemens and Motorola and the joint acquisition of 6 million handsets for 2004, with an average reduction in cost of 10%. November saw the launch of the FreeMove Alliance, a new, simple and easy-to-calculate rate plan for multinational companies, regardless of which network the phone is connected to, with no fixed costs, regardless of use, with a simple system based on geographical subdivisions;
- **Open Mobile Terminal Platform**: TIM and other major mobile telephone operators (mm02, NTT DoCoMo, Orange, SMART Communications, Telefonica Moviles, T-Mobile and Vodafone) founded the Open Mobile Terminal Platform (OMTP) association, with the aim of promoting various projects in relation to the creation of a new open reference framework for manufacturers of mobile terminals and suppliers of associated hardware and software. The aim is to develop the Open Mobile Terminal Platform, that is, standard open interfaces which ensure that users have a more effective, broader user experience when using different handsets. At the same time, this will enable individual operators and suppliers to differentiate and customize their offering. During the year, many other operators joined the initiative, such as Amena, Hutchinson 3G, KPN, SFR Cegetel and Telenor;
- **Protocol Agreement for the Online Conciliation Procedure**: On July 23, 2004, TIM and the leading Italian Consumer Associations signed the Protocol Agreement for the online conciliation procedure regarding the settlement of disputes between the company and its customers. The Protocol is representative of the continuity of the commitments made in previous agreements between the company and the consumer associations;
- **Healthcare Information Services via SMS**: Health Telematic Network (HTN), a leading company in the field of remote healthcare services, and TIM, have launched the first services for healthcare information on the Italian market to be dispensed via mobile phones;
- **Talks** : This revolutionary software enables the blind, the partially sighted and the elderly to use all the functions of a mobile phone and be completely independent, thanks to an electronic voice which reads the display to the user. Blind persons will now be able to read and write SMS and e-mails, compose and download multimedia messages (MMS), call and edit a number in the memory, change the way the phone is used and modify other settings, organize the engagements diary, write and read text documents; and
- **Launch of Video Sharing service**: In collaboration with Nokia, this multimedia service enables customers to introduce visual elements to telephone conversations.

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

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

V VALUE ADDED SERVICES

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

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In order to offer a wider range of services and content to its customers, TIM has strengthened its partnerships with some important providers like Acotel, Zed, Buongiorno Vitaminic and brands like Disney, MTV, Mediaset. TIM also has agreements with leading Italian banks and financial institutions to provide on-line trading and mobile banking and it was the first operator to launch the MSS Mobile Banking service in 2003.

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

TIM has been the first in Europe to introduce the PhotoMessage service (TIM Click), and in 2003 it enriched its multimedia portfolio by offering Java games (including Multiplayer) and Video.

In October 2003, TIM was the first mobile operator to launch mobile TV. The services contents are available pursuant to agreements between TIM and major TV channels.

In April 2004, TIM launched *Programma per le aziende*, an offering addressed to its business customers, aimed to increase both revenues and penetration of mobile services such as browsing and e-mail management. The *Programma per le aziende* allows business customers to upgrade the PC Cards they already own to 3G technology: UMTS (launched in June, 2004), EDGE (launched in September 2004), and dual /EDGE/UMTS (expected for the second half 2005).

V BILLING

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

V MARKETING AND DISTRIBUTION

TIM believes that its active marketing programs, extensive customer service and distribution network (primarily a nationwide network of independent dealers) and responsiveness to customer needs provide it with a significant competitive advantage. At December 31, 2004, there were 1,394 distribution partners, with 4,167 sales points (including 64 Telecom Italia Group outlets marketing TIM products and 26 shops directly owned by TIM). As of December 31, 2004, TIM employees (about 54% of its total workforce) were involved in customer service activities. TIM has adopted a multi-channel approach for its customers: large companies are served with a direct sales channel, that is able to implement complex and customized solutions. SME and SoHo business costumers are supported by indirect sales channel (external agents) as well as a pull channel (franchisee, own shops and dealers). In terms of offering TIM also enhanced and customized the offers for its business customer base (e.g. proposing FreeMove offers to MNCs or dedicated offers to SME) in order to match customers needs (voice and value added services).

V **CELLULAR NETWORK**

TIM's GSM/EDGE/UMTS network consists of about 13,300 radio base stations and 683,300 radio channels (an increase of 5% over 2003). In 2004 TIM completed the countrywide upgrade of the GSM platform in order to support EDGE technology. At the same time TIM continued UMTS network planning and implementation, extending coverage to all regional large towns, as per 3G license requirements, and to many additional clients and areas of interest. In 2004 TIM launched the TIM Turbo service offering mobile EDGE services with data transmission capabilities significantly higher than GPRS and almost equal to UMTS. TIM's TACS (analogue) network consists of about 2,700 radio base stations and 34,800 radio channels. TIM continued to reduce the TACS network capacity; the network's switch off is planned at the end of 2005.

V **SERVICES-INTERNATIONAL**

TIM continued to consolidate its role in the international mobile market during 2004. TIM International's presence is now primarily concentrated in Latin America and in Turkey. In December 2004, in addition to customers in Italy, TIM had more than 27.5 million total managed lines in its subsidiaries abroad (including

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minorities), corresponding to 15.7 million proportionate lines (weighted for TIM's stake in each company). 42% of TIM's international lines are European mobile lines (other than Italian mobile lines) while 58.% are Latin American mobile lines. See 4.2.2 Mobile Companies Controlled by TIM International. TIM International agreed to sell its stake in TIM Hellas and Corporacion Digitel as well as certain other equity sales. On May 5, 2005, regulatory authorities in Venezuela refused the authorization for the sale of TIM International's stake in Corporacion Digitel S.A. to CANTV. Because the decision is subject to administrative and judicial review and TIM International intends to pursue appropriate remedies, at March 31, 2005, TIM treated TIM Hellas and Digitel as discontinued operations. Consequently, as of March 31, 2005, TIM International managed 15.9 million lines, all in Latin America, excluding the lines of affiliated company AVEA (its Turkish joint venture). The lines of AVEA rose to 5.2 million as of March 31, 2005, from 4.8 million as of December 31, 2004.

In-Europe, TIM's pan-European tariff, introduced in 2001, combines the preferential roaming agreements among TIM, its foreign subsidiaries and other European partners, allowing TIM customers to roam in 30 countries using the same tariff. As part of its international roaming service, TIM offers its customers the possibility of making calls from abroad with a simplified rate plan. Subscribers are allowed to use the same rates twenty-four hours a day and prepaid customers to charge the cost directly to their remaining credit rather than to a credit card. See 4.2.2 Mobile Companies Controlled by TIM International.

On July 31, 2003, a cooperation agreement was signed as part of the alliance of TIM, Orange S.A., T-Mobile and Telefónica Móviles. The agreement established the context for developing widespread collaboration and to highlight the joint effort to provide an experience "without borders" to all customers in the geographical areas in which the companies operate.

On December 11, 2003 the Alliance was formally incorporated into a Dutch Association with full legal capacity having its corporate seat in Amsterdam. Subsequently, in July 2004 the Association changed its corporate name to Free Move.

The FreeMove alliance, which is initially operating in Europe in the primary service areas of the four mobile companies, will reach nearly 170 million customers in twenty-one countries. Its goal is to expand and to include in the project all the activities of each company on a worldwide level.

The initial products and services provided will allow customers who use prepaid cards to utilize their mobile phones in a larger number of countries than is currently possible, enjoying their usual services e.g. voicemail and assistance even when traveling abroad. The service of recharging prepaid cards abroad will gradually become available. In addition, GPRS and MMS roaming will then become available in the leading countries in Western Europe. One of the objectives of the four operators is also to improve services for businesses.

The main goals of the alliance and the corresponding supporting actions are:

- increase roaming services and correlated voice and data traffic;
- reduce costs, leveraging on stronger purchasing power towards suppliers;

- improve customer proposition by offering state-of-the-art/exclusive terminals for FreeMove Alliance members. Preferential supply agreements have already been signed with Siemens and Motorola;
- strengthen operators' brand and positioning by means of higher quality service perception; and
- improve competitive positioning with the multinational company market by offering 'one stop shop' solutions.

The alliance's partners shall also guarantee roaming for third generation services within the end of the year.

TIM is focusing its efforts on becoming a technological and marketing partner for its affiliates. Examples of synergies implemented among TIM and affiliated companies are represented by the commercial launches of TIM Celular (formerly TIM Sao Paulo) in 2002 and TIM Perú in 2001. TIM's strategy for international development focuses on consolidation in countries where TIM believes new markets have greater growth potential. Targeted countries include Brazil (for GSM services) and Perú. These markets currently have low penetration rates and dense populations made up of young consumers who are more oriented towards value added services. See 4.2.2 Mobile Companies Controlled by TIM International .

V HOLDINGS OF INTERNATIONAL OPERATIONS

As a result of a corporate reorganization completed at the end of 2000, TIM acquired 100% of STET Mobile Holding (SMH), the international holding company of the Telecom Italia Group holding substantially all of the

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Telecom Italia Group's wireless investments outside of Italy. On December 28, 2001, SMH merged with TIM International, the holder of stakes in Digitel and Is TIM. TIM International is managed by TIM and the international results have been fully consolidated with TIM's results since January 1, 2001. Following the TIM Acquisition TIM International will be a wholly owned subsidiary of Telecom Italia. In January 2001, TIM Brasil, a wholly owned subsidiary of TIM International, was formed to act as a sub holding company for the subsidiaries which acquired PCS licenses in Brazil (TIM Celular Centro Sul, TIM Sao Paulo and TIM Rio Norte). In recent years, TIM International has significantly reorganized its operations in Brazil. See 4.2.2 Mobile Companies Controlled by TIM International Latin America .

In January 2004 the merger of five of the operating companies of Tele Nordeste Celular Participações Group (Telpa Celular, Telasa Celular, Telepisa Celular, Telern Celular and Telecearà Celular) into the subsidiary Telpe Celular was completed. Telpe Celular changed its corporate name to TIM Nordeste Telecomunicações and remains the sole operating company in which Tele Nordeste Celular Participações has a stake.

On April 19, 2004, TIM International agreed to settle several lawsuits between TIM International and the other shareholders of Digitel. The lawsuits concerned losses for the fiscal year 2002 which were covered in 2003. 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). The aforesaid settlement agreement was executed on July 1, 2004. As a result, TIM through TIM International holds 100% of the shares of the Venezuelan mobile operator.

On November 5, 2004, TIM entered into a Memorandum of Understanding with CANTV (Compania Anonima Nacional Telefonos de Venezuela) for the disposal of the entire stake in Digitel held by TIM International. The transaction was subject to execution of a final agreement and the granting of the relevant authorizations by the Venezuelan authorities.

At December 31, 2004, the overall number of TIM lines calculated on a proportionate basis, in Italy and internationally, was approximately 42 million. Starting from November 2004 TIM International has entered into agreements to dispose of its stakes in TIM Hellas as well as Digitel. When these transactions close, in aggregate, it will reduce TIM's proportionate lines by 3.2 million. There are approximately an additional 1.1 million equity mobile lines calculated on a proportionate basis that are part of the Telecom Italia Group, excluding Entel Chile.

The following tables list the countries in which TIM (through TIM International) currently has operations, the ownership interest in each operator and the number of lines for each operator. Until February 29, 2004, all the Latin America companies owned by TIM International were coordinated by Latin America Operations. Starting from March 1, 2004, the Latin America Operations function is no longer operational (please see 4.2.3 South America for further details).

Controlled Operations

<u>Country</u>	<u>Operator</u>	Percentage interest of TIM International	Total Wireless lines per operator at December 31,
----------------	-----------------	--	---

			2004
			(millions)
Europe			
Greece	TIM Hellas	80.74(1)	2.3
Latin America			
Brazil	Maxitel		
	TIM Participações	100.00(2)	2.4
		23.73(3)	5.7
	TIM Celular	100.00	5.5
Perù	TIM Perù	100.00	1.1
Venezuela	Digitel	100.00(4)	1.4

1. On April 3, 2005 an agreement was signed to sell TIM's stake in TIM Hellas to private equity partnerships managed by Apax and Texas Pacific Group. The sale, which is subject to the receipt of regulatory approvals, is expected to close by July 2005.
2. In February 2002, TIM Brasil acquired 10% of ordinary shares of Maxitel, corresponding to 3.33% of the total capital. On September 29, 2004 TIM International contributed its own stake in Maxitel to TIM Brasil. On October 28, 2004 TIM Brasil contributed its 100% stake in Maxitel to TIM Celular, in the form of a capital increase.

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- On August 30, 2004 Tele Nordeste Participações merged into Tele Celular Sul Participações. At the same time Tele Celular Sul Participações changed its company name to TIM Participações S.A..
- On November 5, 2004, a memorandum of understanding for the sale of Corporacion Digitel was reached by TIM with CANTV (Compania Anonima Nacional Teléfonos de Venezuela). On May 5, 2005, regulatory authorities in Venezuela decided not to grant authorization for the proposed sale. The decision is subject to administrative and judicial review and TIM International intends to pursue appropriate remedies.

Affiliated Companies

<u>Country</u>	<u>Operator</u>	<u>Percentage interest of TIM International</u>	<u>Total Wireless lines per operator at December 31, 2004</u> (millions)
Europe			
Czech Republic	T-Mobile CZ	4.35(1)	4.4
Turkey	Avea (formerly TT&TIM)	40.0(2)	4.8

- On March 24, 2005 TIM sold its remaining stake of 7.16% of the share capital of CMobil (Dutch holding owning 60.8% of T-Mobile CZ) to T-Mobile Global Holding. This participation corresponded to an indirect stake of 4.35% in T-Mobile CZ, one of two largest operators in the Czech Republic. The overall value of this transaction was 70.5 million.
- On February 19, 2004, Is TIM was merged with Aycell. The new company (Avea, formerly TT&TIM) resulting from the merger is currently held by TIM International (40%), Turk Telekom (40%) and by the Is Bank group (20%). Please see below 4.2.2 Mobile Other Investments Held By TIM International Turkey .

V COMPANIES CONTROLLED BY TIM INTERNATIONAL**Europe****Greece**

The Telecom Italia Group's first international investment in Western Europe was the establishment of TIM Hellas (previously known as Stet Hellas). TIM Hellas was awarded one of two GSM licenses granted in Greece, in the 900 Mhz frequency band, and commenced commercial services in June 1993.

In July 2001, the company was awarded a UMTS license, for 145 million (of which approximately 101 million has already been paid) and a DCS 1800 license for 26 million. At December 31, 2004, TIM Hellas had approximately 2.3 million lines. In 2004, operating revenues were 838 million against 805 million in 2003 (an increase of 4.1%); and operating income was 127 million against 166 million in 2003. The decrease in operating income is mainly due to the amortization of the UMTS license, launched in

January 2004.

TIM Hellas was listed on NASDAQ and on the Amsterdam Stock Exchange in June 1998 through an initial public offering of American Depositary Shares on NASDAQ and of Dutch Depositary Receipts on the Amsterdam Stock Exchange. After completion of the initial public offering, the Telecom Italia Group's stake through TIM International was reduced from 74.8% to 58.14%. In February 2001, a stake of 1.14% was acquired by TIM International. In October 2001, TIM International subscribed to a capital increase to finance the acquisition of its new business, and its stake rose to 63.95%. In August 2002, TIM International acquired the 17.45% stake of Verizon, its original joint venture partner. Consequently, the TIM group's interest in TIM Hellas was 81.40%.

In October 2004, Stet Hellas Telecommunications S.A. changed its corporate name to TIM Hellas Telecommunications S.A..

In December 2004, TIM Hellas increased its share capital by issuing new shares reserved for the subscription by certain of its key officers/employees, pursuant to a Stock Option Plan introduced on December 2000. Consequently, the TIM group's interest held through TIM International in TIM Hellas was reduced from 81.40% to 80.74%. In March 2005 TIM International acquired shares in TIM Hellas held by Telecom Italia Finance increasing its stake to 80.87%.

On April 3, 2005 TIM International reached an agreement for the disposal of its 80.87% equity stake in TIM Hellas to private equity funds advised by Apax Partners and Texas Pacific Group (TPG). The price of the transaction is 1,114 million which corresponds to an enterprise value of 1,600 million for 100% of TIM Hellas and is equivalent to approximately 16.43 per share.

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The closing of the transaction, subject to, among other things, the approval by the competent authorities, is expected to occur by the end of July 2005.

Latin America**Brazil**

In 2001, TIM Brasil (a wholly owned subsidiary of TIM International) was incorporated to act as a sub holding company for TIM Celular Centro Sul, TIM Sao Paulo and TIM Rio Norte. In November 2001, TIM International's stake in Bitel (the majority shareholder of Tele Nordeste Celular and Tele Celular Sul) was contributed to TIM Brasil. Consequently, TIM Brasil remained the holding company for all the Brazilian subsidiaries. In September 2003 Bitel Participações S.A. merged with the controlling company TIM Brasil and changed its name to TIM Brasil Serviços e Participações S.A. In December 2003, following the approval of the Boards of Directors of the Brazilian companies holding an 80% interest of Blah! S.A. formerly TIMNet.com S.A. (Tele Nordeste Celular, Tele Celular Sul, Maxitel and TIM Celular), such stake was sold to TIM International N.V., that became the sole owner of Blah! S.A..

TIM Participações. On January 30, 2004, the Extraordinary Shareholders Meeting approved the merger of the operating companies controlled by Tele Nordeste Celular (Telasa Celular, Telpa Celular, Telern Celular, Teleceará Celular and Telepisa Celular) into Telpa Celular. Following this merger, Telpa Celular's name was changed to TIM Nordeste Telecomunicações S.A..

The objective of the merger of the operating companies by Telpa Celular was to integrate the activities of the six operating companies that pertain to the same business group, taking advantage of synergies, allowing for the expansion of Telpa Celular's operations, reducing expenses relating to maintaining six distinct legal structures and concentrating the liquidity of shares of operating companies controlled by Tele Nordeste Celular.

On May 28, 2004 the Boards of Directors of Tele Celular Sul Participações and Tele Nordeste Celular Participações (both controlled by TIM Brasil) approved the commencement of the transaction for the merger by incorporation of Tele Nordeste Celular Participações into Tele Celular Sul Participações. The shares of both companies were traded on the Sao Paulo Stock Exchange (BOVESPA) and the NYSE (as privileged shares, in the form of ADR's or American Depositary Receipts).

On July 19, 2004 the Boards of Directors of Tele Celular Sul Participações and Tele Nordeste Celular Participações approved a merger by incorporation. On August 19, 2004 the Extraordinary Shareholders Meeting of Tele Nordeste Celular Participações approved the merger by incorporation in Tele Celular Sul Participações. On August 30, 2004 the Extraordinary Shareholders Meeting of Tele Celular Sul Participações also approved the merger and the change of its corporate name to TIM Participações S.A.. At the end of the transaction, TIM Participações remains controlled by TIM Brasil and its shares continue to be listed on both the BOVESPA and the NYSE.

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At the end of 2004 TIM Participações had 5.7 million lines (an increase of 34%) representing an overall market share of 44%.

On April 26, 2005, the Board of Directors of TIM Participações S.A., approved the merger with its controlled companies TIM Sul S.A. and TIM Nordeste Telecomunicações S.A. in which TIM Participações is the surviving entity.

This merger aims mainly to concentrate the liquidity of the shares of the three companies into one, reduce certain expenses related to maintaining corporate controls in each company and to eliminate multiple shareholders in three separate entities.

As a result of this transaction, the capital stock of TIM Participações S.A. will be increased in the amount of R\$415,068,708.68. This increase will be represented by up to 160,311,357,056 shares of which 28,724,403,535 will be common shares and 131,586,953,521 will be preferred shares, all of which will be issued by TIM Participações S.A.. However, the number of issued shares may be lower as a consequence of the exercise of withdrawal rights by the shareholders of TIM Sul and TIM Nordeste. TIM Participações S.A. has only one class of common shares and one class of preferred shares.

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At the end of the year TIM Participações reported operating revenue of Brazilian reais 2,706 million (744 million) an increase of 18.6% in local currency (compared to 2003); and operating income of Brazilian reais 594 million (163 million), an increase of 13.4% in local currency compared to 2003.

Maxitel. In November 2000, TIM, through Bitel Participações, acquired from UGB Participações S.A. and Vicunha S.A., respectively, 19.43% and 18.53% of the ordinary and preferred shares of Maxitel, the Brazilian mobile telephony operator licensee in the states of Minas Gerais, Sergipe and Bahia in which it already held a 58.7% interest (43.15% of ordinary share capital). The transaction involved a total investment of approximately U.S.\$240 million.

In February 2002, TIM International, through its wholly owned subsidiary TIM Brasil S.A., acquired from the minority shareholders UGB Participações S.A. and Vicunha S.A. the remaining 10% of Maxitel ordinary shares for the equivalent of 27 million by exercising a call option.

In order to streamline and simplify the corporate structure, TIM International contributed its participation held in Maxitel to TIM Brasil share capital. Following authorization from regulatory authorities, the transaction was approved by TIM Brasil's Board of Directors in September 2004. Subsequently, in October 2004 TIM Brasil contributed its 100% stake held in Maxitel to TIM Celular, in the form of a capital increase.

At the end of 2004, Maxitel had 2.4 million lines (an increase of 50.6% compared to 2003).

In 2004, Maxitel reported operating revenues of Brazilian reais 1,076 million (296 million), an increase of 20.9% in local currency compared to 2003, due to an increase in traffic; an operating loss of Brazilian reais 26 million (7 million). The decrease was mainly due to increased commercial costs due to increased competition.

TIM Celular S.A.. On February 13, 2001, TIM's subsidiaries, TIM Sao Paulo and TIM Celular Centro Sul acquired PCS licenses in Brazil respectively in the states of São Paulo and the Paraná, Santa Catarina, Rio Grande do Sul, Goiás, Tocantins, Mato Grosso do Sul, Mato Grosso, Rondonia, Acre, Brasília DF. On March 13, 2001, TIM Rio Norte acquired PCS licenses in the states of Rio de Janeiro, Espírito Santo, Minas Gerais, Amazonas, Roraima, Amapá, Pará, Maranhão, Bahia, Sergipe, Piauí, Ceará, Rio Grande do Norte, Paraíba, Pernambuco and Alagoas. On October 18, 2002, the three companies launched GSM services. In December 2002, within the framework of the corporate reorganization process, TIM Sao Paulo merged with the other two companies and, in January 2003, changed its name to TIM Celular.

In April 2004, TIM Brasil contributed to TIM Celular some operating activities previously managed by TIM Brasil.

The company operates mobile network services using GSM technology in the north of Brazil, in the middle/west and south region and in the states of São Paulo, Rio de Janeiro and Espírito Santo and in the Districto Federal.

At the end of 2004, TIM Celular had 5.5 million lines. In 2004, TIM Celular reported operating revenues of Brazilian reais 2,854 million (784 million); and an operating loss of Brazilian reais 912 million (250 million) compared to a loss of Brazilian reais 1,278 million (368 million) in 2003.

Perù

In March 2000, TIM Perù was awarded the third mobile PCS license in the country at a cost of U.S.\$180 million. The license has a duration of 20 years, is renewable, and provides for the supply of mobile telecommunications service on the 1900 MHZ frequency band. The license permits TIM Perú to request licenses for supplementary services, including basic and long distance telephone services. These licenses were obtained in March 2001 and October 2001.

The Telecom Italia Group has elected to use GSM technology for its mobile services in Perù consistent with the development of a Latin American platform and GSM roaming worldwide.

At the end of 2004, TIM Perù had 1.1 million lines (an increase of 76.9% compared to 2003).

In 2004, TIM Perù reported operating revenues of Nuevo Soles 701 million (165 million) an increase of 39.6% in local currency compared to 2003, and an operating loss of Nuevo Soles 22 million (5 million) against an operating loss of Nuevo Soles 128 million (32 million) in 2003.

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Venezuela

In December 2000, TIM acquired a 56.6% stake in Digitel, a Venezuelan mobile operator. The amount paid for this acquisition was approximately U.S.\$363 million (of which approximately U.S.\$107 million was in the form of a capital increase and the balance was in the form of a share purchase). In December 2002, TIM International acquired a further 10% of Digitel's share capital for 32 million. In May 2003 TIM International acquired a further 0.56% of the company shares, consequently, as of December 31, 2003 the TIM group's interest in Digitel increased to 67.12%.

On April 19, 2004 TIM international signed an agreement to acquire the remaining 32.88% of Digitel share capital from its minority shareholders, in connection with the settlement of certain lawsuits. The transaction was finalized on July 1, 2004. As a result TIM International holds 100% of Digitel's share capital.

Digitel was awarded a 900 MHZ 20-year renewable GSM license in January 1998 and is operating in the Venezuelan Central Region, which, including Caracas and other major cities, is the most important economic region of Venezuela, with 62% of the national GDP.

In November 2004, TIM entered into a Memorandum of Understanding with CANTV (Compania Anonima Nacional Telefonos de Venezuela) for the disposal of its entire stake in Digitel held by TIM International. The transaction was subject to execution of a final agreement and the granting of the relevant authorizations by Venezuelan authorities. On May 5, 2005, regulatory authorities in Venezuela decided not to grant authorization for the proposed sale. The decision is subject to administrative and judicial review and TIM International intends to pursue appropriate remedies.

As of December 31, 2004, Digitel had approximately 1.4 million lines (an increase of 18.6% compared to the end of 2003).

In 2004, Digitel reported operating revenues of Bolivares 453,786 million (174 million), an increase of 51.9% in local currency against operating revenues of Bolivares of 298,681 million (148 million) in 2003; and an operating income of Bolivares 30,046 million (11 million) against an operating loss of Bolivares 19,702 million (10 million) in 2003.

V OTHER INVESTMENTS HELD BY TIM INTERNATIONAL

Turkey

In line with its expansion strategy in the Mediterranean Basin, in April 2000, the Telecom Italia Group was awarded a mobile GSM 1800 license in Turkey. This license was acquired, at a price of U.S.\$2,525 million, through a special consortium (49% owned by Telecom Italia and 51% by Is Bank, the leading private bank in Turkey, in compliance with restrictions imposed by local laws about

foreign investments). The second license was awarded to the fixed network operator (Turk Telekom, through the wholly owned operator Aycell) at the same time, according to the terms of the bid.

In September 2000, the Telecom Italia Group and Is Bank formed Is TIM, that, under the brand name Aria, launched GSM services on March 21, 2001. According to the agreements with Is Bank, TIM was responsible for the technical and commercial operation of Is TIM. In December 2000, 49% of Is TIM was transferred to TIM International B.V. (now TIM International N.V.).

During the start-up, the results of Is TIM were adversely affected due to the difficulties faced by Aria Is TIM in developing its mobile business, because of the Turkish regulatory context. In fact beginning with the award of the license, certain measures which should have fostered effective competition and permitted a new entrant to compete against incumbent operators (roaming arrangements in particular), did not effectively take place. These measures are essential, in the light of international experience, to foster competition. While Aria Is TIM and its shareholders made repeated and formal efforts pursuant to applicable legislation in Turkey to have the situation rectified, Aria-Is TIM was de facto prevented from entering the Turkish mobile telephony market in contravention of the terms and conditions of the tender.

From a financial standpoint, at the end of 2002, Telecom Italia, in conjunction with TIM, concluded that the competitive conditions which would permit TIM to earn a return on investment did not exist. Facing this situation

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Telecom Italia and TIM wrote off their investment in Aria Is TIM in full. The investment held in Aria Is TIM was written down (extraordinary loss of 1,491 million) and a provision was added to the reserve for risk and charges related to Aria Is TIM (850 million) against the guarantees provided by the Telecom Italia Group to financial institutions and suppliers as creditors of Aria Is TIM and the loans to Aria Is TIM by the Telecom Italia Group.

Aria Is TIM filed a request for arbitration with the International Chamber of Commerce against the authority for telecommunications, which was, however, discontinued after the authorization for the joint-venture with Aycell described below.

On May 13, 2003, TIM International signed a Term Sheet with Turk Telekom (the fixed line operator) outlining a set of guidelines for the integration of Aria Is TIM and Aycell (the 4th Turkish mobile operator wholly owned by Turk Telekom). On February 19, 2004, the merger of Aria Is TIM with Aycell was completed after receipt of the required regulatory approvals. Turk Telekom and TIM each hold a 40% stake and Is Bank Group holds the remaining 20% in the new joint venture, called TT&TIM.

TIM s contribution to the new joint venture, TT&TIM, consisted solely of its equity interest in Aria-Is TIM, which, as mentioned above, had been written off in full at December 31, 2002. During 2004, TIM International invested 23 million in Aria Is TIM in order to permit the reduction of Aria Is TIM s debt to the level agreed by the shareholders of the joint venture. TIM International offset this investment in its reserve for risks and charges.

Based on its current knowledge, the previous accounting adjustments, TIM s current investment plans and TT&TIM s current business plan, Telecom Italia does not expect TT&TIM s operating results to have any material impact on Telecom Italia s consolidated results of operations or financial condition over the next two years.

TT&TIM started to operate under the two brands of Aria and Aycell and its ambition is to compete for the second position in the Turkish market. TT&TIM launched its new brand Avea on June 23, 2004. On October 5, 2004, the General Shareholders Meeting of TT&TIM resolved to change their company name to Avea Iletisim Hizmetleri A.S..

At the end of 2004, Avea had a customer base of approximately 4.8 million lines.

On May 3, 2005, TIM International subscribed to a further U.S.\$35 million (approximately 27 million) capital increase in AVEA, in order to satisfy the cash needs of the company.

Czech Republic

The Telecom Italia Group held a 7.16% interest in C-Mobil B.V., a company which owns a 60.8% interest in T-Mobile CZ (previously known as Radiomobil), a mobile telecommunications operator, which in March 1996 won a GSM license in the Czech Republic. On March 24, 2005, the Telecom Italia Group sold this stake.

4.2.3 SOUTH AMERICA

All the activities conducted by the Latin American subsidiaries (whether controlled by Telecom Italia International or by TIM International) were coordinated by Latin America Operations (LAO) until February 29, 2004 and were developed in accordance with the Telecom Italia Group's overall strategic plan. From February 2003 to February 2004, Latin America Operations reported directly to the CEO Carlo Buora for Wireline telecommunication, and to Marco De Benedetti for Mobile telecommunications. Since March 1, 2004, the Latin America Operations function is no longer operational and the Business Units have been given responsibility for the results of the subsidiaries for which they are accountable in Latin America. Effective March 1, 2004, Paolo Dal Pino was appointed the representative of the Telecom Italia Group in Latin America, reporting directly to the Chairman. In particular, the Wireline and Mobile Business Units have been given responsibility for the results and the day-to-day operations of the wireline and mobile operations, respectively, of such subsidiaries.

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- invest in high-growth market segments, such as wireless, data and broadband, through the creation of a common GSM platform and through the launch of VAS services based on state-of-the-art technologies that provide synergies to the Telecom Italia Group;
- enhance the value of shareholdings, maximizing efficiency and cash cost control particularly on legacy services; and
- strengthen its role of strategic partner in the current operations by increasing the transfer of the Telecom Italia Group's technological expertise and marketing know-how.

V LATIN AMERICA COMPANIES CONTROLLED BY TELECOM ITALIA INTERNATIONAL

Chile

Entel Chile was, until 1994, the monopoly long distance operator in Chile. Since 1994 the Entel Chile Group has significantly enlarged its activities becoming a full operator maintaining its leadership positioning in the long distance segment while introducing mobile services, through its two PCS licenses acquired in 1998, as well as local, Internet and data services.

Since introducing mobile services, Entel Chile has achieved the leading position in wireless telecommunications with a 39.3% market share representing approximately 3,265,000 mobile lines at the end of 2004 (an increase of 21.6% compared to 2003).

Consolidated operating revenues during 2004 were 925 million representing a decrease of 3.8% against 2003 (962 million). During this same period the Chilean peso increased in value by 3% against the Euro. In local currency terms Entel Chile also recorded a decrease in revenues of 6.6% due to a sharp decline in the wireline segment (a decrease of 12.6%), mainly due to the negative performance of long distance operator Americatel (an affiliate of the Chilean Group in the USA) which has been negatively impacted by the unexpected strengthening of the competitive position of the Competitive Local Exchange Companies (CLECs), furthermore the decline is also related to the continuous decrease on the Chilean Long Distance market, mainly due to the well known substitution effects of both the mobile and Internet services. Mobile revenues continuous to present growth (an increase of 3.1%).

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During the last two years the Company has focused on reducing costs levels, seeking to improve its margins as well as growth in profitability and cash generation.

On January 24, 2005 Telecom Italia International N.V. executed a stock purchase agreement with Almendral S.A., a Chilean holding company publicly traded on the Santiago Stock Exchange, for the sale of all its 129,530,284 shares (54.76% of the share capital) of Entel Chile S.A. for a total consideration of U.S.\$934 million.

The transaction closed on March 29, 2005 and Telecom Italia International N.V. received an initial payment of U.S.\$834 million. The remaining amount (U.S.\$100 million) was paid on May 24, 2005.

This transaction falls under the Telecom Italia Group's strategy to rationalize its international portfolio and focus on areas of strategic interest with growth potential.

Bolivia

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

During 2004, operating revenues were 152 million, an increase of 0.7% compared to 2003 (151 million), primarily attributable to the weakening of the Bolivian currency against the euro, although revenues in local currency increased by 13.9%. Revenue growth was mainly driven by the mobile business (an increase of 22.4%) where the company maintains its strong market leadership (67.3%), while the wireline business registered a decrease of 12.9% due to the general market contraction related to an unstable political and economic environment during the course of 2004, as well as to aggressive competition.

An efficiency plan applied to both operating and capital expenditures together with a significant reduction of the interconnection costs resulted in important improvements in productivity and profitability.

As of December 31, 2004, Entel Bolivia had 1,146,000 mobile lines, up 46.4% from the end of 2003 (783,000 mobile lines) and 50,000 fixed lines subscribers, substantially stable when compared with 2003.

Nortel Inversora

In December 2003, the France Telecom Group and the Telecom Italia Group contributed their respective stakes in Nortel (corresponding in total to 67.78% of its capital) to a new Argentinean registered holding company, Sofora Telecomunicaciones S.A. which had been organized in September 2003 and was held 50% by the Telecom Italia Group and 50% by the France Telecom Group. On December 19, 2003, France Telecom transferred to the Wertheim Group (Argentinean Group) a 48% stake in the Sofora Telecomunicaciones share capital for U.S.\$125 million, and a call option on the remaining 2%, exercisable from January 31, 2008 to December 31, 2013. In order to provide the rules governing their relationship, Telecom Italia, Telecom Italia International and Wertheim Group signed a shareholders' agreement. Moreover, Telecom Italia International purchased from Wertheim Group two call options for U.S.\$60 million. The first call option for the purchase of 48% of Sofora Telecomunicaciones share capital can be exercised within 30 business days after December 31, 2008, and the second call option for the purchase of an additional 2% of Sofora Telecomunicaciones share capital can be exercised between December 31, 2008 and December 31, 2013.

The current interest of 50% the Telecom Italia Group holds in the Nortel ordinary share capital (through Sofora Telecomunicaciones) is the result of the acquisition of an initial share of 32.5% in 1990 for approximately U.S.\$33 million and a further share of 17.5% in August 1999 for approximately U.S.\$265 million.

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Nortel currently owns 54.74% of Telecom Argentina, which as from November 1990 to October 1999 operated on an exclusive basis the telecommunications network in the northern part of Argentina (including Buenos Aires), providing local and long-distance (national and international) fixed telephone services. Additionally, Telecom Argentina Group provides mobile telecommunications services, data transmission services, value-added services and directories publishing. Since October 1999, the Argentinean market has been progressively liberalized, and as a consequence of this Telecom Argentina has expanded its operations to the entire national territory. In June 1999, Telecom Argentina also expanded its mobile telecommunications services, by acquiring new licenses in the PCS technology, for a total nominal amount of U.S.\$327 million.

At the end of 2004, Telecom Argentina had accumulated 3,484,000 fixed-line network subscribers. Its subsidiary Telecom Personal (including Nucleo Paraguay) which is a leading company in the wireless segment (both in revenues and customers), accumulated 4,338,000 mobile lines (75% with prepaid cards), with a market share of 28% in Argentina and 41% in Paraguay. The group is moving to GSM technology with an accumulated investment of U.S.\$104 million in 2003 and 2004.

In the Internet sector, at the end of 2004, there were approximately 233,000 subscribers (152,000 narrowband clients and 81,000 broadband clients).

Revenues of the Telecom Argentina Group were Argentine Pesos 4,495 million (1,228 million) in 2004, an increase of 20.0% from Argentine Pesos 3,746 million (1,123 million) in 2003.

During 2004, the Argentine economy continued recovering from the significant economic decline of late 2001 and early 2002. As a result, Telecom Argentina's fixed clients increased by 3.7% compared to December 2003, although the current level of lines in service is still lower than before the economic crisis (December 2001). The Argentine mobile segment recovered strongly during 2004 both in traffic terms (an increase of 46.2%) and clients (an increase of 47.3%). The economic recovery was positively influenced by the international environment (particularly high commodity prices and low interest rates) while structural changes in the country are still pending.

Argentina launched its proposal for a comprehensive restructuring of its outstanding public debt with private creditors, reaching a level of consent of approximately 76% of the total outstanding eligible public debt with private creditors in March 2005. At the moment, the treatment of the holdouts and the new negotiation with the multilateral official lenders, including the International Monetary Fund (IMF) are still pending.

In January 2002, the Argentine Government enacted Law No. 25,561, which provided, among other aspects, the pesification of tariffs (establishment of an exchange rate for dollar-denominated prices and rates of Argentine Pesos 1 =U.S.\$1) and the renegotiation of the conditions of the contractual agreements entered into between privatized companies and the Argentine Government. Negotiations with the national government on new contract and applicable tariff to fixed telephony are still pending.

As a result of the devaluation of the Argentine peso and subsequent pesification of Telecom Argentina's tariffs in January 2002, the uncertainties of the economic situation and the regulatory environment in which the Telecom Argentina Group had operated, on March 27, 2002 and June 24, 2002, the Board of Directors of Telecom Argentina and its subsidiaries in Argentina defaulted on their

principal and interest payment obligations under their debt agreements.

As part of its restructuring plan, based on a voluntary tender offer in June 2003 (with a subscription rate of 44%) Telecom Argentina Group repurchased U.S.\$292 million of principal amount of its debt using cash of U.S.\$161 million at a price of 55% of face value. In addition Telecom Argentina Group paid the full amount of the interest accrued as of June 24, 2002 and 30% of the interest accrued from June 25, 2002 to December 31, 2002.

On January 9, 2004, Telecom Argentina announced its proposal for a comprehensive restructuring of all of its outstanding unsecured financial debt. Telecom Argentina proposed to implement its proposal pursuant to an Acuerdo Preventivo Extrajudicial , or an out-of-court restructuring agreement governed by Argentine law (APE). Pursuant to the terms of the APE, Telecom Argentina proposed to restructure all of its outstanding unsecured financial indebtedness through different options including the issuance of new unsecured non-convertible notes (the New Notes) and/or cash payments. The unsecured commercial indebtedness will be paid in accordance with its original terms and conditions.

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In June 2004, Telecom Argentina commenced solicitation of powers of attorney or commitments to approve and execute an APE. On October 21, 2004, after reaching a level of consent of 82.35% of the total creditors representing 94.47% of the total financial indebtedness of Telecom Argentina as of August 31, 2004, the APE was filed for approval of the reviewing court.

On February 4, 2005, the reviewing court called for a meeting of noteholders. All of the creditors who attended the meeting voted in favor of the restructuring proposal described in the APE and ratified the form of consideration to be paid, assuming the APE is approved by the reviewing court.

From the date the APE was filed, the reviewing court has been requesting Telecom Argentina to produce additional documentation which Telecom Argentina submitted in due course. The approval of the Argentinian Court is pending.

Although Telecom Argentina expects that the restructuring process will be successfully completed during 2005, there can be no assurance that the APE will be approved by the reviewing courts in the timeframe provided in the APE.

On the other hand, as part of the Telecom Argentina Group's restructuring process, in November 2004 Telecom Personal and Nucleo, the subsidiaries of Telecom Argentina, completed the restructuring of their outstanding indebtedness representing 12% of the total Telecom Argentina Group's indebtedness. As of December 31, 2004, such restructured Telecom Personal and Nucleo debts amounted to approximately U.S.\$415 million of the total Telecom Argentina Group's indebtedness which amounted to approximately U.S.\$3,576 million.

4.2.4 INTERNET AND MEDIA

Internet and Media Business Unit operates in the following segments:

- **Internet Services.** Management of access services (ISP), with Tin.it, management and development of portals (Virgilio with Matrix), and web services, where it occupies a leadership position in the Italian market. As part of a restructuring of the Telecom Italia Group's Internet assets Telecom Italia Media is selling its Internet Services to Telecom Italia;
- **Television.** La7 and MTV, both in the sectors of production and broadcasting of publishing content through television transmission networks entrusted under concession, and in the marketing of advertising space in TV programming; and
- **Office Products and Services.** Through the distribution of products, services and solutions for the office through the Buffetti retail network.

The Internet and Media Business Unit accounted for gross operating revenues of 597 million in 2004, 1,297 million in 2003 and 1,991 million in 2002.

As of December 31, 2004, the Business Unit was organized as follows (the table shows the main companies/consolidated activities):

INTERNET	TV	INTERNET AND MEDIA NEWS	OFFICE PRODUCTS	OTHER ACTIVITIES
Tin.it(1)	La7	TM News	Buffetti Group	Databank (2)
<u>Matrix(1)</u>	MTV		Sk Direct	Televoice (3)

- (1) On April 4, 2005 the Boards of Directors of Telecom Italia and Telecom Italia Media met and approved the restructuring of the Telecom Italia Group's Internet business whereby Telecom Italia will acquire all of Telecom Italia Media's Internet activities. The proceeds of such sale will be used by Telecom Italia Media to, among other things, expand its business.
- (2) On March 14, 2005 Telecom Italia Media completed the sale of its 100% stake in Databank, to Centrale dei Bilanci Srl and Cerved Business Information SpA, each of which is acquiring 50% of the share capital.
- (3) On December 16, 2004 Telecom Italia Media reached an agreement with Comdata (Altair Group) for the disposal of 100% of Televoice S.p.A.. On January 3, 2005, the transaction was completed.

V INTERNET SERVICES

Telecom Italia Media offers a full range of Internet services, consisting of:

- Internet access services;

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- portal services;
- on-line advertising services; and
- web services.

Internet Access Services

Through Tin.it, Telecom Italia Media provides Internet access services to residential, SOHO and SME Internet users. The SOHO market consists of businesses that use telephone lines to connect to the Internet, as opposed to dedicated lines, and is made up of small businesses, generally with one or two employees, and businesses conducted out of the home. The SME market consists of businesses having between 3 and 50 employees.

Tin.it offers two principal access subscription plans:

- free access (Tin.it Free); and
- premium access (dial-up, ISDN and ADSL access).

On December 31, 2004, Tin.it's subscriber base amounted to approximately 3.3 million active users (defined as users who connect to the Internet at least once every 45 days).

<u>Million</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>
Active users(1)	2.2	2.5	3.3

(1) Active users include Telecom Italia's ADSL Alice subscribers to whom Tin.it provides certain services.

During 2004, Telecom Italia Media enhanced its Tin.it brand and range of products by developing the ADSL and WI FI connection, in particular:

- the development of the WI FI network continued reaching 730 hot spots, of which 603 are active and 127 are soon to be activated. This achievement ranks TIN.IT's hot-spots network as one of the first WI FI networks in Italy based on the number of locations reached;

- in March 2004, the entire ADSL customer base migrated from a speed of 256 MB to 640 MB.

Portal Services

Telecom Italia Media provides portal services through Matrix, which operates the Virgilio portal.

Virgilio is a leading Italian portal, with approximately 7.9 billion web page views in 2004 and approximately 6.6 billion web page views in 2003, that caters to the Italian speaking community on the Internet. Management believes that Virgilio, which has been on-line since July 1996, is one of the most complete Italian portals. It contains a search engine and a websites index, and centralizes services in various interest areas such as stock quotes, weather forecasts, TV guides, games, chats, advertisements and shopping. In order to simplify the use of information, Virgilio offers personalized, interactive services that correspond to the requirements of individual customers.

In 2004, Virgilio launched a new home page with a significant increase in traffic and turnover. Product innovation is one of the most important basis for future evolution of Virgilio and it represented the primary focus for investment during 2004.

On-line Advertising Services

Matrix's division *Active Advertising* is a leading on-line advertising agency in Italy and has arrangements with approximately 20 Italian websites to provide advertising services.

Web Services

Telecom Italia Media provides web services through Tin.it and Matrix Communication.

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V TELEVISION

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

La7 provides news information on a 24-hour basis, and is currently cooperating with the Internet Services business segment to provide on-line news information through the use of video-streaming technology. La7 started broadcasting under an all news format on March 18, 2002.

MTV Italia is a television channel providing music programs on a 24-hour basis. The brand MTV is a well known brand in the music industry and in the television network business. MTV Italia started broadcasting its programs on May 1, 2001.

During 2004, the broadcaster La7 sought to consolidate its editorial image, its brand awareness and its programs. In particular, La7 is now perceived as a high-quality broadcaster and its Auditel audience rating was, in the month of December 2004, 2.6% (2.2% for the same period last year). Over the same period, MTV continued to reign as Italy's premier youth television channel, with increasing revenues (an increase of 25.3% from 64 million in 2003 to 80 million in 2004) and an operating profit that increased by 78.9% from 4 million in 2003 to 7 million in 2004.

Growth in gross advertising sales for television segment (La7 and MTV), increased by approximately 16.5% compared to 2003.

In September and October 2004, as part of the DTT development projects, La7 Televisioni acquired the pay-per-view rights to broadcast soccer matches played by certain Serie A teams, the top soccer division in Italy. The total amount of the transactions was approximately 32 million for the three-year period 2004-2005, 2005-2006 and 2006-2007. The service, launched in January 2005, calls for the purchase of a rechargeable smart card and the sale of pay-per-view events without a subscription fee.

La7 and MTV also continued experimenting with new services related to digital terrestrial television. The Italian population currently covered by the DTT signal is approximately 67%.

V OFFICE PRODUCTS AND SERVICES

Through Gruppo Buffetti S.p.A. (Buffetti), during 2004 Telecom Italia Media was a leading distributor of office products and business solutions in Italy.

V MAJOR 2004 CORPORATE EVENTS

- On February 3, 2004, the City of Pesaro and La7 Televisioni S.p.A. signed a memorandum of understanding for the experimentation of digital terrestrial television (DTT) directed to the development and broadcasting of publicly-useful interactive services for the City of Pesaro.
- On February 11, 2004, Telecom Italia Media S.p.A., Sun Microsystems Italia, a leader in network systems, and CSP Innovazione in ICT (Information-and-Communication-Technology Research Center) signed an agreement for the experimentation of innovative services for digital terrestrial television in the Province of Turin.

v **EVENTS SUBSEQUENT TO DECEMBER 31, 2004**

- On April 29, 2005, La7 signed an agreement with Elefante TV S.p.A. to acquire the company's national TV broadcast unit for 115,5 million. Elefante TV holds a private television broadcasting concession for terrestrial frequencies over the national territory. The company also holds an authorization for digital broadcasting.

On the same date, La7 signed an agreement to purchase radio/television plants and frequencies from local concession holder Delta TV, which operates in Central and Southern Italy, for a total amount of 12 million.

The closing of the transaction is subject to, among other things, the approval by the competent authorities.

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4.2.5 INFORMATION TECHNOLOGY MARKET

The Information Technology Market Business Unit (IT Market) brings together all the information technology companies and activities of the Telecom Italia Group directed to the external market. The Business Unit, IT Market as a whole, is among the ICT (Information Communication Technology) leaders at the national level, the largest Italian-owned ICT group, a leader in providing solutions for public administrations and transportation companies, and one of the top five suppliers of solutions for banks.

The customers of the IT Market Business Unit include some of the largest central public administrations, the leading Italian banking groups, companies belonging to the national railway group Ferrovie dello Stato, more than 1,000 local organizations, health and transportation authorities, social security agencies and insurance groups.

As of December 31, 2004, IT Market Business Unit was organized as follows:

Information Technology Market

Finsiel group:

- Finsiel S.p.A.

- Banksiel S.p.A.

- Insiel S.p.A.

- Tele Sistemi Ferroviari S.p.A.

Eustema S.p.A.

IT Market Business Unit performance in 2004 may be summarized as follows:

- Government operations have benefited from cost-cutting drives over the last two years, increasing volumes and improved profitability margins;
- Transport and Industry operations and Tele Sistemi Ferroviari, in particular, reached higher operating revenues, offset by the strong pressure on prices which reduced profitability; and
- Finance operations and Banksiel in particular, performed lower operating revenues and reduced profitability margins, as a result of the disposal of a number of assets and lower customer tariffs.

V **MAIN SUBSIDIARIES THE FINSIEL GROUP**

Finsiel provides services in the field of information technology and related activities, including services for local and central government entities. In addition, Finsiel provides management consulting and services related to company automation. Finsiel is the leading Italian firm in the systems integration and information technology consulting market, and one of the largest European companies of this type. Finsiel is the principal supplier of systems integration and information technology consulting to the Italian government and local government authorities, typically under long-term exclusive arrangements.

The Finsiel Group is a business solutions provider for government, banks and businesses.

Agreement for the sale of Finsiel S.p.A. to the COS Group

On April 26, 2005 Telecom Italia signed a sale and purchase agreement with Al maviva Technologies, the COS Group holding company, for the sale of its entire stake (79.5%) in Finsiel S.p.A.. The execution of this agreement completes a competitive sale process for the controlling stake held by Telecom Italia in Finsiel S.p.A. and follows a preliminary agreement signed with Al maviva Technologies on February 24, 2005. The transaction is based upon a Finsiel enterprise value of approximately 164 million.

The closing of the transaction, subject to, among other things, the approval by the competent authorities, is expected to occur by the end of July 2005. At the closing, Telecom Italia will transfer to the buyer 59.6% of Finsiel's share capital, while the remaining stake of 19.9% will be transferred by the end of 2005, after the exercise of a put/call option.

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Following the preliminary agreement, Telecom Italia adjusted Finsiel's carrying value to its estimated sales value in its consolidated financial statements. Therefore, in the consolidated financial statements, a provision of 27 million was set aside in a specific reserve. This transaction also makes it possible to book, in the 2004 financial statements, deferred tax assets of 38 million, arising from the write-down of Finsiel's carrying value to 115 million, made by Telecom Italia in fiscal year 2002.

4.2.6 INFORMATION TECHNOLOGY GROUP

The Information Technology Group (IT Group) Corporate Function is responsible for coordination, technological innovation and service of information technology activities within the Telecom Italia Group. The IT Group focuses on the core business of TLC, pursuing objectives such as the efficiency and improvement of quality and innovation, with the aim of implementing economies of scale and achieving advancements in terms of performance.

IT Telecom group and EPIClink S.p.A. were included in the scope of consolidation of this Corporate function.

On September 9, 2004, the Board of Directors of Telecom Italia S.p.A. approved the plan for the merger of the wholly-owned subsidiaries IT Telecom S.p.A. and EPIClink S.p.A into Telecom Italia. This plan falls under a broader reorganization of the Information Technology Group area.

Bringing the activities of these two subsidiaries within Telecom Italia will make it possible to rationalize the use of resources and technological expertise and will lead to simplification of the operational, administrative and corporate management processes.

The merger was effective as of December 31, 2004 and for accounting and tax purposes from January 1, 2004. On December 30, 2004, IT Telecom S.p.A. transferred its Data Center business segment to IT Telecom S.r.l., a new company set up on November 12, 2004.

As of December 31, 2004, the IT Group Corporate Function was organized as follows:

After the above mentioned merger, the IT Group Corporate Function was organized as follows:

Wireline the development and the applications of the OSS and BSS systems and the development, design, delivery and management of VAS for the Wireline market have been transferred to the Wireline Business Unit, the aim being to integrate end-to-end processes so as to maximize the operating synergies between demand management and development activities.

Corporate Central Functions the activities relating to the definition of the reference architectures used in the Business Unit projects have been allocated to the Telecom Italia Corporate Functions with the aim of making Telecom Italia Group IT strategies more uniform.

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IT Telecom S.r.l. the activities of creating and operating IT Group infrastructures (Data Centers) have been allocated to IT Telecom S.r.l. with the aim of maximizing synergies and encouraging the convergence process.

V MAJOR 2004 CORPORATE EVENTS

- On March 31, 2004, under the program for the reorganization of Telecom Italia Group's information technology area, the Development business segment was sold to TIM S.p.A., effective April 1, 2004. The Development business segment carries out activities currently conducted by IT Telecom S.p.A. for TIM regarding:

innovative services, based on IP networks, known also as e-business or web services, directed at the business and mass-market segments, and

telecommunications software development and maintenance activities.

These activities were integrated with the resources that already operate in IT development in the Mobile Business Unit, making it possible to improve the synergies for the management of the current platforms and the development of their evolution. The sale price, based also upon an outside appraisal by Milestone Advisory House S.p.A. in Milan, was agreed between the parties at 23 million. 551 employees were transferred.

- On September 8, 2004, the Board of Directors of IT Telecom S.p.A. voted to transfer to Shared Service Center S.c.r.l. (SSC) in which a 40.91% stake is held the following business segments: (i) ERP Solutions, engaged in the development and maintenance of ERP systems, and (ii) Application Operations Administration & Finance, which guarantees applications management for the systems in the administration and finance areas. The ownership interest remained unchanged as the other SSC shareholders (TIM S.p.A., 4.54%, Olivetti Tecnost S.p.A. renamed Olivetti S.p.A. on April 5, 2005 4.54% and Pirelli S.p.A. 50.00%) subscribed to their part of the capital increase.

4.2.7 OLIVETTI TECNOST

Olivetti Tecnost (recently renamed Olivetti) and its subsidiaries (the Olivetti Group) operates, in the sectors of ink-jet products for the office; digital printing systems, development and production of products associated with silicon technology (ink-jet print-heads and MEMS) and provides specialized applications for the banking field and commerce and information systems for gaming and lottery management.

In addition, it operates with Nuove Iniziative Canavese in document management services and fixed and cell phone repair.

The principal markets of this business unit are Europe and Asia.

As of December 31, 2004, the Olivetti Tecnost Business Unit included the following companies:

Olivetti Tecnost Group

Olivetti Tecnost S.p.A. (1)

- Olivetti I-Jet S.p.A.
- Innovis S.p.A.
- Cell-Tel S.p.A.
- Wirelab S.p.A.
- Olivetti Tecnost International B.V. (foreign sales companies)

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

(2) On January 14, 2005, the sale of 60% of the subsidiary Innovis S.p.A. from Olivetti Tecnost S.p.A. to the partner Comdata S.p.A. was executed; after this operation Innovis S.p.A. is owned 80% by Comdata S.p.A. and 20% by Olivetti Tecnost S.p.A.. As of December 31, 2004 Innovis employed 222 units.

(3) On March 7, 2005, the sale of 65% of the subsidiary Cell-Tel S.p.A. from Olivetti Tecnost S.p.A. to the partner Telis S.p.A. was executed; after this operation Cell-Tel is owned 85% by Telis S.p.A. and 15% by Olivetti Tecnost S.p.A..

V OFFICE PRODUCTS

In 2004 the office products operations, including Olivetti I-Jet, continued to demonstrate the positive trends begun in 2003. Growth was confirmed along with European leadership in the area of fax machines with ink-jet technology. The number of fax machines sold during the year increased by approximately 150,000 (or 34%) compared to the prior year.

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Sales volumes of digital photocopiers, another important segment of the office business, increased by 38% compared to the year 2003.

Investment plans are being implemented to support activities for the development and manufacture of new fax machine models and other ink-jet technology new products on an industrial scale.

With reference to the process of rationalizing the European network, the back-office activities of foreign affiliates were outsourced and concentrated in the services center of the Accenture group in Prague.

V SYSTEMS

The results for the year 2004, net of exchange rate effect, are higher than those for 2003, both with respect to revenues and margins, and from a standpoint of business initiatives to promote geographical and product diversification.

In particular, in the Gaming sector an important contract was signed and completed during 2004 for the supply of approximately 25,000 terminals for operating an electronic voting system in Venezuela.

In addition, the Olivetti Group began supplying terminals for video-games to the Czech Republic and won an order worth more than U.S.\$2 million for a total supply of 2,000 terminals for automated gaming in China (Shanghai Welfare Lottery). With reference to the Italian market, sales of terminals for the video-lottery have begun.

In the Banking sector, in 2004, Olivetti succeeded in maintaining its 2003 market share in Western countries, where there was a generalized downturn. Sales volumes increased on Eastern markets, where approximately 134,000 specialized printers were sold (of which approximately 100,000 in China).

The performance of the Shop Automation business was again stable with regard to volumes of conventional fiscal Cash Registers where more than 48,000 units have been sold.

V NUOVE INIZIATIVE CANAVESE

The activities relating to Nuove Iniziative Canavese increased significantly compared to 2003. In particular, the subsidiary Cell-Tell acquired new customers and extended its line of service to repairing and regenerating fixed telephone equipment; however, the increase in volumes has not been sufficient to obtain positive results.

The subsidiaries Innovis (back-office activities) and Wirelab (repair and regeneration of telephone exchanges) both increased their business and, consequently, their number of employees.

* * *

In 2004, a contract was signed between Olivetti Tecnost and the TILAB function of Telecom Italia, for the sale of intellectual property through the acquisition by Telecom Italia of research and development projects and activities carried on by Olivetti Tecnost and authorized by TILAB. A contract was also signed for the payment of royalties by Olivetti Tecnost to Telecom Italia for use of the Olivetti brand and another was signed for the utilization of patents and the same intellectual properties.

4.2.8 OTHER TELECOM ITALIA GROUP ACTIVITIES

The Other Activities of the Telecom Italia Group principally consist of the TILAB Function, the companies which provide centralized services to the Group, and the Corporate Functions.

Centralized Group Services include centralized services performed for the Business Units/Corporate Functions/Companies of the Group.

V REAL ESTATE AND GENERAL SERVICES

The activities performed by Real Estate and General Services are related to the planning of sites and locations of the Telecom Italia Group, the design and construction of civil works, the maintenance of the properties and technological plants, in addition to providing real estate and general services.

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V **TELECOM ITALIA LAB**

Telecom Italia Lab is responsible for supervising technological innovation within the Telecom Italia Group. This is achieved by searching for new technologies, preparing and examining research and feasibility studies and developing prototypes and emulators of new services and products, with a special focus on the main topics of strategic interest to the individual Business Units. It operates to promote Telecom Italia Group's technological leadership and also exploits collaboration with Pirelli Labs.

The activities can be broken down into Telecom Italia Group's main innovative areas of interest, such as: developing the access network to cope with the growing demand for bandwidth availability, developing the carrier network, with a gradual transition towards optical technologies, developing telephone services, in view of the convergence of the network architecture towards an all-IP model, developing third generation hi-tech services and terminals of the new generation for the mobile area and contributing to the evolution of the Internet and multimedia.

Telecom Italia Lab relies on the expertise of Telsy, the Telecom Italia Group company which, since 1971, has worked to develop and produce equipment for security in telecommunications with cryptographic functions.

As of December 31, 2004, the Function TI LAB was organized as follows:

	TILAB
Telecom Italia TILab segment	
Telsy S.p.A.	

TILAB medium and long-term research activities are organized as follows:

Network Innovation and Access Network & Terminals: devoted to short and medium/long term R&D projects on fixed and mobile network infrastructures, with a focus on the segment of core networking, radio access, Broadband access and innovative terminals.

Services & Platforms Innovation and Business Applications & Services: concentrates on the creation of services and the testing of prototypes through innovative platforms, for the consumer and business markets, respectively.

TILAB also used its Testing Laboratories to test both equipment acquired from suppliers and prototypes developed through research.

V **OTHER SUBSIDIARIES**

Telecom Italia Finance S.A.

Telecom Italia Finance S.A. (TI Finance) organized in the Grand-Duchy of Luxembourg as a Société Anonyme, is a 100% owned subsidiary of Telecom Italia. TI Finance provides financial assistance to Telecom Italia as well as companies in which Telecom Italia has a direct or indirect interest through, providing loans and the granting of guarantees for securities of any kind or form. TI Finance also may borrow in any kind or form and issue bonds or notes.

In October 2004, the Extraordinary General Meeting of Telecom Italia Finance resolved to:

- reduce the share capital to discharge accumulated losses as of June 30, 2004, of 729,844,921;
- further reduce the share capital to constitute an undistributable reserve of 390,627,449;
- increase the share capital of 499,999,996 and to constitute a reserve equal to 1,005,671,163. This increase has been subscribed by Telecom Italia S.p.A. by way of contribution of all the shares representing the Edotel S.p.A. share capital.

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Moreover:

- Starting from January 1, 2004, the merger of Olivetti International S.A. (OISA) into Telecom Italia Finance became effective for fiscal and accounting purposes.
- On June 1, 2004, Olivetti Finance N.V.S.A. (OFNV) was merged into Telecom Italia Finance which assumed all its liabilities and assets.
- In July, 2004, Olivetti International N.V. and Olivetti International Finance N.V., wholly-owned subsidiaries of Telecom Italia Finance, were liquidated.
- On December 20, 2004, the wind-up of the subsidiary RAP S.A. was closed.

Telecom Italia Capital S.A.

The company is a directly and indirectly wholly-owned subsidiary of Telecom Italia, organized under the laws of Luxembourg, and was established in the year 2000 as the finance vehicle to issue notes in the U.S. market.

On October 8, 2004, Telecom Italia Capital floated a new bond issue for a total of U.S.\$3,500 million to fund the financial requirements of the Telecom Italia Group companies, including Telecom Italia.

4.2.9 COMPETITION

Fixed-line Domestic and International Telecommunications Services

As a result of the complete liberalization of the market for telecommunications services, the Telecom Italia Group has faced increasingly significant competition since 1998 in the Italian domestic market, including competition from foreign telecommunications operators.

The legal framework for regulation in the telecommunications sector in Italy was completely transformed, as a consequence of the adoption of the Maccanico Law (effective August 1, 1997), the Presidential Decree No. 318/97 (the Telecommunications Act) (effective September 22, 1997) and a series of Orders issued by the National Regulatory Authority which have been important to the Telecom Italia Group as it has faced increasing competition. To date the regulatory environment has been characterized by an intensive implementation process in order to complete liberalization. See 4.3 Regulation .

Since the beginning of 1997 about 170 licenses have been activated in Italy, although at the end of 2004 about 50 OLOs were still active and offering telecommunication services. In fact, in this period, many companies failed or were involved in merger and acquisition operations.

Wireline in its domestic market faces, among others, two national players, Tele2 and Wind, and three other focused competitors: Fastweb (focused on broadband and specific cities), Albacom (focused on business customers) and Tiscali (focused on Internet). Only two of these competitors have their own network facilities, Fastweb and Albacom, while the others principally implement a reseller model utilizing Telecom Italia's network. The development of broadband solutions has been pushing some operators (i.e. Wind, Fastweb) to utilize an ULL model.

Telecom Italia's market share in retail traffic volumes (retail voice and on-line traffic only) at December 31, 2004 was 72.2% compared to 72.0% at December 31, 2003, 71.4% at December 31, 2002 and 72.1% at December 31, 2001. Significant competitors are Tele2 and Wind; Albacom and Fastweb are less significant competitors, in specific targeted markets (business customers for Albacom; high spending consumers for Fastweb).

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

In this competitive environment during 2004 Wireline was nonetheless able to increase revenues and improve profitability. The improvements were due to:

- The strong growth of Broadband with 4,430,000 access lines at the end of 2004, of which 420,000 in the European market, 2,230,000 accesses more than 2003.

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- Significant revenue growth in ADSL (+108% compared to the end of 2003), Innovative Data Transmission (+20% compared to the end of 2003) and Value Added Services on Data (+35% compared to the end of 2003).
- The maintenance of its market share on traffic both on Voice-Online (an increase of 0.2% compared to December 31, 2003) due to a successful loyalty campaign, with more than 5.8 million loyalty packages subscribed, and limited impact on its customer base from the unbundling of the local loop.

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

Telecom Italia believes that its combination of service, performance, quality, reliability and price is an important factor in maintaining its strong competitive position.

Mobile Telecommunications Services

The Italian Mobile Market. The mobile telephone market continued to grow in Italy in 2004, faster than in previous years (10.8% in 2004 compared to 3.6% in 2003 and 7% in 2002). By December 31, 2004, the number of cellular phone lines reached 63.2 million, corresponding to a penetration rate of around 109% of the population.

This increase is mainly due to the performance of H3G(3), the operator offering exclusively UMTS services. Competition for mobile telecommunications services remained strong in 2004. Consequently, TIM's strategy has been focused on strengthening its leadership with customers with a high mobile phone usage. TIM's strategy to attract and retain such customers has been to:

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

There are three principal competitors to TIM in the Italian mobile market: Vodafone, Wind and H3G(3). At December 31, 2004 TIM remained the market leader with a market share of approximately 42%, with Vodafone, Wind and H3G(3) having market shares of approximately 35%, 19% and 4%, respectively. In 2004, TIM had a 8.2% market share of net additional GSM lines, corresponding to 0.5 million of net lines, compared to 1.5 million for Vodafone, 2.2 million for Wind and the remaining 2.3 million attributable to H3G(3). It should be noted that TIM's figures do not include 688,000 silent lines in order to ensure greater consistency between the number of lines managed and business development. In addition, TIM is the only operator in Italy that reports the customer base figure net of those lines.

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

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

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The Regulatory Framework

In a scenario of increasing liberalization, the decisions taken by the National Regulatory Authority have greater impact. The most significant measures taken by the National Regulatory Authority were the designation of TIM and Omnitel as providers with considerable market strength in terms of cellular service, interconnection, the definition of new pricing scheduled for fixed-to-mobile communications, and the introduction of mobile number portability.

TIM's role in the New Economy. The opportunities offered by new technologies will accelerate the ICT (Information and Communication Technology) convergence process, linking the two currently fastest growing businesses: mobile communications and the Internet. TIM's strategic choice with respect to this convergence is the open model. TIM does not focus on Internet content but, rather, it creates alliances with the best content producers in order to provide its customers with the most innovative and the widest range of opportunities, while guaranteeing customers transaction security.

Traditional Business and Value Added Services. The development of new advanced services is necessarily impacting TIM's revenue structure. Value Added Services have and will continue to account for a rising proportion of revenues compared to those generated by voice traffic. TIM's growth will be increasingly dependent on its ability to develop data traffic and innovative services.

This means the mobile sector is one of the segments with the highest potential growth rates and profitability. Technological developments and data transmission will generate new business models based on the capability of offering information, entertainment and advertising through mobile phones and of executing an increasing number of commercial and banking transactions. The capability to develop synergies between fixed and mobile services will allow cost reductions and higher revenues.

TIM will seek out commercial synergies with web-oriented companies on the market which will increasingly demand mobile services (information and media, on-line banking and trading, geographic positioning information system).

In this regard TIM is leveraging on the competitive advantage related to the integration of different technologies and networks (GPRS, EDGE and UMTS) so that the services offered are available regardless of the network being used at any given moment.

EDGE which at present involves only upgrading the GSM/GPRS software and which is complementary to UMTS permits TIM customers to have prompt access to the main third generation services as the EDGE network has a speed similar to that of UMTS (200 kbit/s for EDGE vs 384 kbit/s for UMTS). Due to the availability of dual mode terminals (EDGE/UMTS) marketed with the Turbo TIM brand, TIM customers are able to use the band they need for a specific service regardless of the network they are using.

UMTS is the natural evolution of EDGE: UMTS was launched in May 2004 for corporate clients and in December 2004 for the mass market, when new models of handsets with a more reliable technology became available.

During 2004, Vodafone has introduced the full range of UMTS technology, while H3G(3) introduced it in 2003.

Table of Contents**Item 4. Information On The Telecom Italia Group****Regulation****4.3 REGULATION****4.3.1 OVERVIEW**

A new regulatory framework has been introduced in Italy by the incorporation of recently adopted EC Directives, the Framework directive together with three directives on Access, Authorization and Universal Service (the Data Protection directive was implemented separately). The new rules have been effective in the national regulatory framework since September 16, 2003. In this connection, Law No. 166 of August 1, 2002, gave the Government a mandate to implement the new directives, and to adopt a code of legal and regulatory measures in the field of telecommunications. Furthermore, the European Commission published Recommendations on important product and services markets in electronic communications, as well as Guidelines for market analysis and the evaluation of significant market power.

The new Electronic Communications Code (the Code) implemented the Directives without substantial changes or departures from the text adopted at the European Union level. In implementing the Directives, the Code expressly abolished the former legal framework for regulation of the telecommunications sector in Italy mainly represented by the Telecommunications Regulations, which had been in effect since October 7, 1997.

The main characteristics of the Code are as follows:

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

Moreover, the Directives (and other EU-related regulatory interpretations and recommendations) as implemented by the Code provide for guidelines on market analysis and calculation of significant market power and identify 18 markets at the retail and wholesale level where such analyses and identification shall be conducted. According to the Code, the Italian National Regulatory Authority is still conducting a new evaluation of the operators having significant market power and will soon propose applicable remedies. Within the authority allowed by EU law, the Code also provides for the following:

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

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

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The National Regulatory Authority consists of a President that has been appointed by the Italian Government through a Presidential decree, a Committee for Infrastructures and Networks, a Committee for Products and Services and the Council. Each of the Committees' members is selected by the Italian Parliament (four by the Senate and four by the Chamber of Deputies) and appointed through a Presidential decree. Each of the Committees and the Council is responsible for establishing regulations for their specific areas.

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

The Committee for Products and Services is responsible for, among other things, regulating product quality and conformity with EU directives governing the relationship between companies controlling fixed or mobile telecommunications networks and telecommunications service providers and controlling the operators' compliance with regulation in the field of broadcasting activities (including advertising, children's protection, etc.).

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

The National Regulatory Authority is responsible for:

- market analysis as defined by the Code;
- preparation of regulations in the telecommunications field;
- establishment of the criteria to be followed by operators in determining tariffs;
- monitoring operators to ensure their compliance with such tariff criteria;
- ensuring, where appropriate, accounting separation between different activities carried out by the same operator;
- monitoring of the performance of services to ensure compliance with contracts and qualitative levels of service;

- issuance of directives regarding quality of services;
- examination of complaints filed by users and customers in relation to quality of services and the level of tariffs;
- control of steps taken by operators to ensure equal treatment of their customers and verifying periodically the quality of the service provided; and
- control of operators' compliance with the general principles issued by the Italian Government and the National Regulatory Authority in relation to public services.

The National Regulatory Authority has been operational since June 1998. New members of the National Regulatory Authority will be appointed by Italian Government and Parliament during 2005.

The National Regulatory Authority has investigative powers, as well as the authority to impose sanctions on operators who do not comply with their directives and resolutions. In addition, the National Regulatory Authority is entitled to propose to the Ministry of Communications the revocation and/or suspension of general authorizations and individual licenses in the event of repeated violations by the holder. The Law No. 249 of July 1997 (Maccanico Law) also permits the National Regulatory Authority to limit access to networks for security reasons.

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

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

V UNIVERSAL SERVICE OBLIGATIONS

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

Telecom Italia submitted the net cost of providing universal service for the first time for the year 1998. The National Regulatory Authority concluded that for 1998 the costs of such service were not an unfair burden for Telecom Italia. The National Regulatory Authority appointed an independent advisor to audit the 1999 net costs submitted by Telecom Italia. On August 1, 2000, the National Regulatory Authority recognized a net cost for the provision of the universal service in the year 1999 of 62.4 million. The operators obliged to contribute to finance such net cost were: (a) Telecom Italia (57.1%); (b) TIM (28.1%); (c) Omnitel (13.8%), and (d) Infostrada (1%).

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With Order No. 8/00/CIR Telecom Italia was requested to provide an assessment on the net cost expected for the year 2001, together with information regarding areas and customers estimated as not profitable, in order to allow the National Regulatory Authority to launch a public consultation aimed at determining the guidelines for the provision of the universal service on a competitive basis. On January 31, 2001, pursuant to the same Order, Telecom Italia filed its evaluation for the year 2001. On July 12, 2001, the National Regulatory Authority opened a public consultation in order to assess the possibility of using a bidding procedure for the assignment to operators, other than Telecom Italia, of all or part of the obligations relating to the universal service. The outcome of the consultation was published on January 17, 2002. No decision has been taken by the National Regulatory Authority.

Regarding the net cost of 1999 and 2000, reimbursements have not yet been fully paid to Telecom Italia by the other operators, as some of them have filed a claim in the Administrative Court.

With respect to 1999, on January 27, 2002, the Administrative Court issued a decision in favor of the OLOs, based on procedural grounds only. Consequently, the procedure for the evaluation of the net cost for 1999 was re-opened by the National Regulatory Authority. With Order No. 5/03/CIR the National Regulatory Authority issued a final decision confirming its Order No. 8/00/CIR. However the Italian Supreme Administrative Court, by Decision No. 7257/03 of November 2003, decided to re-open the case. The National Regulatory Authority is expected during 2005 to definitively assess the matter.

The decision of the Administrative Court on the costs of 2000 is still pending.

In December 2001, the National Regulatory Authority published rules designed to grant to low income and to disabled customers certain reductions of the monthly rental fee for voice telephony services.

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

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The National Regulatory Authority approved the net cost sustained by Telecom Italia to provide the Universal Service in 2001 of 40.52 million, to which Telecom Italia itself is to contribute 42.68% (17.29 million), the remaining cost being funded by OLOs (TIM, Vodafone, WIND, Infostrada).

Recently, in February 2005, the National Regulatory Authority approved the net cost sustained by Telecom Italia to provide the Universal Service in 2002 of 37.22 million, to which Telecom Italia itself is to contribute 35.4% (13.2 million), the remaining cost being funded by OLOs (TIM, Vodafone, WIND).

V SPECIAL STATUS OF OPERATORS HAVING SIGNIFICANT MARKET POWER

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

In April 1998, Telecom Italia was identified as an operator having Significant Market Power in the markets of fixed telecommunications networks, fixed-line public voice telephony services, leased lines and interconnection services. Telecom Italia was the sole operator identified as having Significant Market Power for the above-mentioned markets. In April 1998, TIM was identified as having Significant Market Power in the market of mobile telecommunications services. See 4.3.7 EU Telecommunications Law and Regulation The 1999 Review .

With order 197/99 the National Regulatory Authority in September 1999 also determined that TIM and Omnitel had Significant Market Power for mobile telecommunications services and for domestic interconnections. The National Regulatory Authority reviews and evaluates Significant Market Power operators every year.

In Resolution No. 350/02/CONS the National Regulatory Authority confirmed for the year 2000 that the following operators had Significant Market Power:

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

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An inquiry was begun by the National Regulatory Authority on August 7, 2002. An official decision was taken on May 7, 2003, and published in Resolution No. 160/03/CONS of June 3, 2003. The Resolution confirmed for the year 2001 Telecom Italia as having Significant Market Power in the market of public fixed telephone networks and services, leased line systems, and the national interconnection market, as well as TIM and Vodafone Omnitel in the markets of public mobile and national interconnection (termination).

The National Regulatory Authority concluded its inquiry with the aim of identifying the operators with Significant Market Power in the Internet access market (Resolution No. 219/02/CONS sent to Telecom Italia on July 31, 2002). This Resolution identified Telecom Italia and Wind as operators with Significant Market Power in the market of calls terminating on the Internet using dial-up technology, and also identified Telecom Italia alone in the final market of switched Internet access services from the fixed network.

Starting from August 2003, with the introduction of the new European Framework, criteria for the identification of Significant Market Power have changed: the European Commission, with its Recommendation C(2003)497, identified 18 separate markets; the National Regulatory Authority will have to carry out a separate Market Analysis in each market, in order to identify:

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

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In order to do this, the National Regulatory Authority separated the most important markets into the 18 markets identified by the recommendation of the European Commission, and has entrusted a large part of the above-mentioned analyses to external consultants.

The National Regulatory Authority has not yet completed the market analyses in the identified markets to determine significant market power and remedies. Public consultations on markets 1 and 2 (access to the public telephone network at a fixed location for residential and non residential customers) markets 3 and 5 (publicly available local and/or national telephone services provided at a fixed location residential and non residential customers), markets 4 and 6 (publicly available international telephone services provided at a fixed location residential and non residential customers), market 7 (retail leased lines), markets 8, 9 and 10 (call origination and termination on the public telephone network provided at a fixed location and transit services in the fixed public telephone network), market 11 (wholesale unbundled access), market 12 (wholesale broadband access), markets 13 and 14 (wholesale terminating segments and wholesale trunk segments of leased lines) and market 16 (mobile termination) are ongoing and interested parties have submitted their responses. Because the process of market reviews is not completed, it is not possible for Telecom Italia to assess the overall impact of the new regulatory regime on its business.

Interconnection

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

On February 27, 2003 the National Regulatory Authority published Order No. 3/03/CIR, which introduced a network cap, a mechanism for defining in advance the rules for pricing RIO services according to the RPI (Retail Price Index) and productivity factors. The network cap applies for the period 2003-2006. Order No. 152/02/CONS also established non discrimination criteria in interconnection and wholesale market between Telecom Italia and the other licensed operators:

- same conditions to other licensed operators as applied to its retail units;
- further obligations of accounting separation;
- functional separation between network and retail units; and
- price squeeze tests for retail offers.

In compliance with Order No. 3/03/CIR, Telecom Italia submitted the RIO 2003 on April 11, 2003, which was evaluated and approved by National Regulatory Authority with Order No. 11/03/CIR.

On October 31, 2003, Telecom Italia published the RIO 2004 which was evaluated and approved by the National Regulatory Authority with Order No. 3/04/CIR.

On October 29, 2004, Telecom Italia published the RIO 2005, which has not yet been approved by the National Regulatory Authority. Moreover, Telecom Italia has voluntarily undertaken measures (i.e. reduction in the interconnection charges) to support competition (so called *Accordi Parcu*).

Local Loop Unbundling

With Order No. 2/00/CIR issued on March 16, 2000, the National Regulatory Authority published the general guidelines regarding the services that must be offered by Telecom Italia on an unbundled basis: twisted copper pairs; fiber optics; access extension (lines between switches), and digital transmission channels (i.e., digital circuits between the local office of Telecom Italia and the operator's point of presence) and the related economic pricing criteria, based on fully distributed historical costs. The Order allows other operators to have direct access to end users (customers) by leasing the network components from Telecom Italia (full unbundling) as well as leasing only the high bandwidth (shared access).

Telecom Italia appealed this Order to the Regional Administrative Court (TAR Lazio), in particular with respect to the inclusion of fiber optic in the mandatory offer and the costing criteria. On May 12, 2000, Telecom Italia put

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forward a Reference Offer for Local Loop Unbundling, for approval by the National Regulatory Authority. The National Regulatory Authority finally issued Orders 13/00/CIR and 14/00/CIR, respectively on December 30, 2000 and in January 2001. The former regards the technical and procedural aspects of the provisioning of local loop unbundling and co-location. The latter sets the rates for the unbundled services.

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

During 2001, in line with the suggestions made by the National Regulatory Authority, special areas were made available in exchanges to accommodate other operators with the aim of unbundling local loops. In addition, following Resolution No. 24/01/CIR, on December 12, 2001, Telecom Italia presented its rate plan to the National Regulatory Authority for shared access and sub loop (shared access to the local network and access to line boxes).

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

On February 27, 2003, with Order No. 2/03/CIR, the National Regulatory Authority approved Telecom Italia's Reference Offer for 2002 (RIO 2002), after hearing the opinions expressed by the Antitrust Authority and the European Commission, and after Telecom Italia's submission to the National Regulatory Authority of its regulatory accounting for 2001, which took place on December 20, 2002. The RIO 2002 applied to other local operators for the use of Telecom Italia's network, and provided criteria for changing the charges of the RIO 2002 starting in 2003 for the next four years (the so-called network cap).

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

As regards RIO 2003, Order No. 03/03/CIR of February, 27 2003, asked Telecom Italia to set the monthly rental fee on the basis of the following criteria: a) the best European tariff, b) the anticipation of efficiency on operational costs, c) the non-discrimination principle and d) on the basis of the cost structure of access network assets. In the RO 2003, approved by Order No. 11/03/CIR, Telecom Italia published the price for the monthly rental fee for LLU, fixing it at 8.30, which represented the best price in the EU Countries (the incumbent Danish operator price). Order No. 11/03/CIR included additions and changes, particularly regarding the application of the network-cap mechanism, introduced with Order No. 03/03/CIR, for the offer of certain interconnection lines, and for co-sharing, local loop unbundling, partial lines and permanent virtual lines services.

Due to the delay in fixing the cap for the LLU service by the National Regulatory Authority, Telecom Italia published the RIO 2004 on October 31, 2003, maintaining the same level of price for LLU service (8.30/month) as the RO 2003 (even though the incumbent Danish operator price for LLU has now increased to 8.60). In September 2004, around 760,000 unbundled lines were in place, 27 licensed operators requested co-location, 1,043 local switches for co-location were requested by licensed operators and 919 sites were ready for co-location.

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

- the fee for qualification of the ADSL pair will not be applied for all the new lines;
- Telecom Italia will not increase the ULL monthly rental for the POTS/PSTN pair above 8.3 per month until December 31, 2006;
- bonus of 9.6 per year, applied on monthly basis, for each existing or new ULL line.

Public consultation on the market 11 (wholesale unbundled access) is ongoing. The National Regulatory Authority has proposed the introduction of a price cap mechanism (RPI RPI), with a sub-cap for some unbundling services.

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Leased Lines

According to Order No. 304/03/CONS issued on August 5, 2003, by the National Regulatory Authority, Telecom Italia published a new retail and wholesale leased line offer that was approved with Order No. 440/03/CONS on January 29, 2004.

In respect of the previous offer (approved by Order No. 711/00/CONS) the new one introduces a price reduction of between 5.25% and 7% for the retail offer and of 12% for the wholesale offer.

Public consultation on market 7 is ongoing. In the consultation document No. 411/04/CONS the National Regulatory Authority has proposed a price cap of RPI -7% for all the leased lines up to 2 Mgb/s bandwidth (with a specific sub-cap for leased line of 2 Mbit/s bandwidth) and a price cap of RPI -5.25% for all leased lines with bandwidth between 2 Mbit/s and 155 Mbit/s.

Mobile Termination Rate

In Resolution No. 47/03/CONS the National Regulatory Authority set the maximum values for the termination rates applied by mobile operators having Significant Market Power (TIM and Vodafone Omnitel) for calls originated on fixed networks. The ceilings for mobile termination charges have been established at 14.95 cents/min, as from June 1, 2003.

For the non SMP mobile operators (Wind and H3G) the National Regulatory Authority did not establish any ceiling for the termination rates applied to their networks.

On January 28, 2005 the National Regulatory Authority published a public consultation on the telephony calls termination market on single mobile networks (Order No. 465/04/CONS on the relevant market No. 16) . The main new issues are related to:

- the designation of all mobile network operators (TIM, Vodafone, Wind and H3G) as dominant in the telephony calls termination market on their networks;
- for all mobile operators, the introduction of obligations of non-discrimination and publication of a Reference Interconnection Offer which includes at least information about the termination rates and the location of interconnection points;
- the application of a network cap on the termination rates for TIM, Vodafone and Wind for the years 2005-2007;

- the definition for TIM, Vodafone and Wind, of a target value for the termination rate in 2007 of 8.7 cent/min, starting in June 2005 from a value of 12.6 cent/min for Vodafone and TIM and 14.95 cent/min for Wind.

No decision has been taken yet on market 16 (mobile termination) as the consultation procedure was only opened by the National Regulatory Authority on January 28, 2005 (Order No. 465/04/CONS).

Accounting Policies

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

The National Regulatory Authority chose KPMG as the independent advisor for the auditing of the accounting separation reports. In accordance with the Telecommunication Regulations, on September 4, 2000, Telecom Italia submitted the Regulatory Accounting Reports for the year ended December 31, 1999 to the National Regulatory Authority. On September 14, 2001, the Regulatory Accounting Reports for the year ended December 31, 2000 were also submitted to the National Regulatory Authority.

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Due to a delay in the appointment of the independent advisor, the results of the audit on 1999 and reports were published only on November 6, 2002, with Order No. 337/02/CONS. The results of the audit on 2000 Reports were published in March 2003 with Order No. 48/03/CONS.

During 2001 the National Regulatory Authority issued an order which raised the allowed return on capital employed WACC (weighted average cost of capital) for regulatory purposes from 12.5% to 13.5% before taxes.

On June 17, 2002, the National Regulatory Authority issued Order No. 152/02 CONS which requires Telecom Italia to provide more detailed accounting reports on a current cost basis (fully allocated costs); the cost basis previously adopted was the historical one.

On November 18, 2003 Telecom Italia submitted to the National Regulatory Authority the Regulatory Accounting Reports for the year 2001.

After the auditing, in December 2004, AGCOM published, with Order No. 406/04/CONS, the reports of the appointed advisor (KPMG); Telecom Italia, in compliance with Order No. 152/02¹ published on its official web site the Regulatory Financial Statements for the year ended December 2001.

According to the supplied documentation, KPMG stated that, for 2001, the data for the supplied Regulatory Accounting Reports issued by Telecom Italia have as a whole been issued in conformity with the methodological criteria required by law.

On September 17, 2004 and on December 10, 2004 Telecom Italia submitted the Regulatory Accounting Reports for the year 2002 and 2003 respectively. The National Regulatory Authority has not yet appointed the independent advisor to review the two reports.

TIM cost accounting policy. By Order No. 197/99 TIM and Vodafone Omnitel were notified as operators with Significant Market Power in the national interconnection market and must provide a cost oriented fixed-mobile termination rate.

On the basis of Order No. 338/99 TIM was required to implement cost accounting reporting in order to calculate a fixed-mobile termination rate. In accordance with Order No. 340/00, in 2001 TIM produced a cost accounting system based on Fully Allocated Historical Cost Data for the year 1999 (positive certification was issued by the advisor of the National Regulatory Authority at the end of 2002). It also introduced an accounting system based on a FAC-CC model (Fully Allocated Cost on a Current Cost basis), as an intermediate step towards the adoption of long-run incremental costs to determine the fixed mobile rates. In December 2001 the National Regulatory Authority adopted Order No. 485/01 requiring the SMP operators to prepare historical accounts for the year 2000.

With Order No. 399/02, the National Regulatory Authority requested both historical cost data and current cost data for the year 2001; it also required a long run incremental cost orientation for the year 2002 as the last step for cost orientation. Subsequently, with Order No. 47/03/CONS, the National Regulatory Authority decided to implement a three-year Network Cap mechanism (2003-2005) to be applied to the termination rate, in order to grant a gradual reduction of this price. The application of the mechanism for the years 2004 and 2005 will be subject to a new decision, after the completion of the incremental cost modeling, and after the evidence forthcoming from the Market Analyses, under the new Regulatory Framework.

V **NUMBERING**

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

Number Portability (NP)

Since February 2000, following the National Regulatory Authority Orders No. 4/99/CIR and No. 7/00/CIR, which are consistent with EU Directive 98/61/CE, SPP (Service Provider Portability) in fixed networks was introduced, including non-geographic numbers (Premium Rates, Freephone Numbers, Splitting Charges).

¹ Order No. 152/02/CONS states that TLC Operators having Significant Market Power make available to the public the Cost Accounting information within the term of 45 days from the publication by the National Regulatory Authority of the methodological verifications made by the independent advisor.

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SPP allows an end user to retain his number independent of the organization providing service, in the case of geographic numbers at a specific location (same Local Area) and in the case of other than geographic numbers at any location. Implementation of SPP is related to negotiations and technical implementation timing among operators. Telecom Italia upgraded its network and operational systems to be in a position to offer NP consistent with the requirements of the regulations. NP for non-geographic numbers started in May 2000. NP for geographic numbers has been implemented, as well as its synchronization with the unbundling of the local loop.

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

On March 28, 2002, the National Regulatory Authority issued Order No. 7/02/CIR which established that by November 30, 2002, the National Regulatory Authority would have determined the price of Mobile NP (per number costs) that should be equal to the one-off price that the operator receiving the customer/recipient must pay to the operator giving the customer/donor the price. Mobile NP would have been applied starting January 1, 2003. Per cost number should not be higher than the price applied to fixed-line services as established by Order No. 10/00/CIR at 10.02. In January 2003, The National Regulatory Authority issued a new Order No. 13/02/CIR setting a price cap for the portability charge. This charge can not be higher than the price established for Number Portability between fixed operators.

Carrier Preselection (CPS)

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

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

On April 18, 2003, the National Regulatory Authority sent notice to Telecom Italia of Resolution No. 4/03/CIR concerning the Integration of measures with regard to CPS: standards relating to the disconnection of the service . The Order, adopted at the end of the preliminary proceedings which began on November 28, 2002, defines common measures relating to the disconnection of the CPS service, describing in detail the modes and time-scales involved in the disconnection of CPS services, to safeguard users, and stating precise obligations with regard to transparency for operators of the services.

V RIGHTS OF WAY

The Telecommunications Regulations prohibit public authorities from discriminating in the granting of rights of way for the installation of public telecommunications infrastructures. The National Regulatory Authority and the local public authorities can promote the sharing of such structures and rights of way. If the access to such rights of way cannot be granted to a new operator,

the National Regulatory Authority and the local public authorities can allow the access to existing infrastructure. The parties involved agree on the commercial terms of the sharing of the existing infrastructure.

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

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

4.3.4 PUBLIC CONCESSIONS

The Telecommunications Regulations provided that by January 1, 1999, the Public Concessions were to be modified to make them consistent with the new regulatory framework, on the initiative of the National Regulatory Authority, with the aim of bringing the Public Concessions into line with the Telecommunications Regulations. All special or exclusive rights held by Telecom Italia under the former monopoly system, and not compatible with the introduction of competition, were to be considered abolished.

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The National Regulatory Authority opened an inquiry on December 15, 1999, with the aim of bringing the Public Concessions into line with the new regulatory framework, modifying the content of the Public Concessions and eliminating the special and exclusive rights and obligations which were in conflict with the Telecommunications Regulations, such as approval by the Ministry of Communications of the long term and technical plans of Telecom Italia, the installation and operating of public telephone facilities in specific areas of the country, and the development of services in small centers.

At the end of its inquiry, the National Regulatory Authority issued three individual licenses and a general authorization to Telecom Italia formally notified on January 19, 2001:

- An individual license for the installation and provision of public telecommunications networks, and for the provision to the public of voice telephone services (modification of the concessions and associated agreements formerly granted to SIP, Iritel and Italcable).
- An individual license for the installation and operation of a network of coastal stations with the aim of providing mobile maritime services via Inmarsat satellite (modification of the concession and associated agreement formerly granted to Iritel).
- An individual license for the plant and operation of radio-electric boarder stations, and the supply of mobile maritime services and mobile services via satellite through Inmarsat terminals (modification of the concession and associated agreement formerly granted to Sirm).
- Authorization for the supply of satellite network and communications services (modification of the concession and associated agreement formerly belonging to Telespazio).

Each individual license included a list of specific charges, drawn up on the basis of the indications given by the ministerial Decree of November 25, 1997, containing Provisions for the issue of individual licenses in the telecommunications sector.

The licenses and authorizations issued to Telecom Italia have the same expiry date as the Public Concessions (2012, according to Article 14 of Law No. 359/92, containing Urgent measures for the rehabilitation of public finances).

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

However, by Order of September 18, 2003 (joint cases No. C 291/01 and No. C 293/01), the Court of Justice of the European Community stated that the aforementioned telecommunications license fee established by Italian Law No. 448/1998, Art. 20, is contrary to EU law. The same conclusion was reached by the Italian administrative judge (TAR) when ruling with Order No.

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47/2005, published on January 5, 2005 (see also Item 5. Operating and Financial Review and Prospects 5.2 Specific Factors which Impacted Results of Operations Over the 2002-2004 Period 5.2.3 Telecommunications (TLC) License Fee).

Under its Public Concession, Telecom Italia had the right to provide all mobile public telecommunications services, regardless of the technologies used. These rights were transferred to TIM as a consequence of the TIM Demerger. In accordance with the Presidential Decree No. 211 of August 1, 2002, the duration of TIM's GSM concession is 20 years, commencing on February 1, 1995 (before this decree the duration was 15 years).

The Telecommunications Regulations provided that by January 1, 1999, the existing GSM concessions (the GSM Concessions) (Omnitel, now Vodafone Omnitel, also was granted a GSM Concession) were to be modified to make them consistent with the new regulatory framework. In March 2001 the GSM Concessions were transformed into individual licenses.

TIM is also a holder of an individual license for radio mobile analogical (TACS) public service, for radio mobile paging public service and for the installation of their relative networks. The term of validity for the license corresponds to that of the original concession (2012).

According to Resolution No. 286/02/CONS, issued by the National Regulatory Authority on September 25, 2002, all TACS frequencies are to be released and returned to the government, which would then reallocate them on GSM.

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The entire reallocation and rationalization process of the GSM 900 MHz frequency band will take place over three time periods until expiry of the TACS system users scheduled for December 31, 2005. With Order No. 54/04/CONS, the National Regulatory Authority launched a public consultation on the procedures to assign new rights of use on GSM frequencies.

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

4.3.5 LICENSED OPERATORS

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

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

The Italian government awarded five UMTS licenses in Italy in December 2000. TIM, together with Vodafone Omnitel N.V., WIND S.p.A., Andala S.p.A. (now H3G S.p.A.) and IPSE S.p.A., were awarded licenses to provide the third generation mobile services. TIM committed to pay 2,417 million for its license, with 2,066 million paid in December 2000 and 117 million paid in November 2001 and November 2002. The remaining 117 million were paid during 2003.

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

On August 1, 2002, TIM was granted individual licenses for the point multi-point system WLL on a frequency band of 27.5-29.5 GHz and a width of 112 MHz.

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

XDSL/ATM Broadband

In December 1999, Telecom Italia received temporary authorization from the National Regulatory Authority for the wholesale offering of ADSL/ATM access service to Other Licensed Operators and Internet Service Providers. In February 2000, Telecom Italia started the always on retail offering for fast Internet access. The ADSL 640 wholesale offer has been partially modified by the National Regulatory Authority with Order No. 217/00/CONS issued in April 2000. In February 2001, the National Regulatory Authority approved the Permanent Virtual Circuit (ADSL up to 2 Mbit/s and HDSL up to 155 Mbit/s technologies) offer as presented by Telecom Italia and authorized Telecom Italia to offer XDSL retail services branded as RING and FULL BUSINESS COMPANY from April 2001. At the end of 2003, ADSL 640 and XDSL wholesale services were available in 2,120 towns for about 80% of total lines on a national basis.

On April 15, 2003, the National Regulatory Authority with Order No. 6/03/CIR approved the Telecom Italia wholesale x-DSL offer for intermediate services which operators must acquire from Telecom Italia in order to supply ADSL to the public, unless they have their own infrastructures or do not use unbundling. The new range of services includes price reductions for ADSL access, the introduction of longer time-scales for starting to market new wholesale services based on the retail-minus principle, and the integration of an operators Service Level Agreement with regard to the disconnection of services.

In order to increase the quality of Telecom Italia ADSL services, on March 1, 2004 Telecom Italia ADSL 640 wholesale price has been reduced to the same level of the existing ADSL 256 wholesale price. All Telecom Italia ADSL retail customers, both consumer and flat, have been upgraded to ADSL 640 access speed without an increase of the retail price. The OLO/ISP ADSL customer base, based on Telecom Italia wholesale offers, has been upgraded on the base of the requests. Moreover on January 31, 2005, Telecom Italia reduced the price of the ADSL 1.2 Mega wholesale flat offer to the same level of the existing ADSL 640 offer. The consistent upgrading of current access lines will concern only flat rate customers, both retail and wholesale.

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On August 6, 2003, some Internet Service Providers filed a complaint with the European Commission claiming the abuse of dominant position of Telecom Italia in the market of broadband Internet access when bundling it with the provision of exclusive content for its clients. The proceeding, opened by the Commission, is still pending.

4.3.6 TARIFF AND PRICING POLICY***Overview***

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

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

With Order No. 171/99 the National Regulatory Authority described the rules to be applied by Telecom Italia in setting the tariffs for the services offered. The National Regulatory Authority distinguished two kinds of tariffs. The first required prior approval by the National Regulatory Authority and applied to:

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

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

In a new Order (No. 289/03/CONS) the National Regulatory Authority described the rules to be applied by Telecom Italia in setting tariffs for the services offered for the years 2003-2006 introducing a safeguard cap with the aim of maintaining price stability.

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The safeguard cap system provides for 3 different caps as described below:

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

In the public consultation document No. 410/04/CONS, the National Regulatory Authority has proposed to maintain for the years 2005-2006 the same price cap mechanism for the local, national long distance and fixed to mobile (Retention segment) telephone services.

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

In Order No. 304/03/CONS of August 5, 2003, the National Regulatory Authority approved the criteria for the preparation of new rate plans for retail and wholesale leased lines. In particular, the Order involves the re-formulation of Telecom Italia's retail rate plans with a reduction of expenditure of at least 5.25% for direct national lines and 7% for digital 2-Mbit/s lines. As far as wholesale rate plans are concerned, terminations co-shared with a Telecom Italia exchange are to be introduced, along with all the extra services, including RPV-D, diversity of routing and the link of protected access. Furthermore, items of cost must be reduced by at least 12% compared to the prices of the retail rate plans. Finally, the Order involves the re-formulation of the Service Level Agreements of certain conditions relating to the supply of retail and wholesale services.

In Resolution No. 440/03/CONS of December 17, 2003, the National Regulatory Authority confirmed the new rate plans for Telecom Italia's retail and wholesale leased lines, published on October 30, 2003.

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

The 1999 Review

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

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

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

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

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

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

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

A notification will require only the following elements:

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

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

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

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

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

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

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

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

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

- determine appropriate mechanisms for retail price control, such as price caps or specific price floors and ceilings;
- ensure that the Significant Market Power operator sets prices at normal commercial levels;

- notify to the Commission the names of organizations subject to retail price control; and
- retail price control mechanisms should not be applied where effective competition exists.

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

Guidelines on Market Analysis

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

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

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

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

Recommendation on remedies

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

4.3.8 COMPETITION LAW

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

- agreements (including resolutions and concerted practices) aimed at fixing prices, limiting production or access to markets and technological developments, sharing of markets, applying different conditions for the same services to the detriment of competitors, and subjecting contracts to the acceptance of conditions that, according to their nature and common practice, are not linked to the object of the contract;
- abuses of dominant position (including practices aimed at fixing prices, limiting production or access to markets and technological developments, applying different contractual conditions for the same services to the detriment of competitors, as well as subjecting contracts to the acceptance of conditions that, according to their nature and common practice, are not linked to the object of the contract); and
- concentrations of enterprises (i.e., mergers, acquisitions of controlling interests and concentrative joint ventures) which would result in the creation or strengthening of a dominant position. All concentrations in relation to which the combined overall turnover, in Italy, of the companies involved is higher than 377 million or the turnover of the company being

acquired is, in Italy, higher than 37 million, must receive a prior authorization from the Antitrust Authority. These thresholds are adjusted every year to take account of inflation. Failure to file prior notification of a concentration to the Antitrust Authority will result in a fine from 1% to 10% of the turnover of the parties involved in the concentration, or higher in the case of fines for violation of a prohibition of a concentration.

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

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

With respect to competition matters, the decisions of the Antitrust Authority are considered administrative acts and may be appealed before the TAR of Lazio, based in Rome, for violation of law, abuse of power and lack

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of jurisdiction. The TAR may either reject the appeal or declare the Antitrust Authority's decision null and void. The TAR, upon request of the complainant, may also suspend the enforcement of the decision of the Antitrust Authority. The TAR's judgments may be further appealed before the State Council, whose decision is final.

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

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

Moreover, the competition rules of the EU (EU Competition Law) also have a direct effect in Italy. The main principles of EU Competition Law are contained in Articles 81 and 82 of the Treaty of Rome. Article 81 prohibits agreements or concerted practices between undertakings that may affect trade between Member States and has the object or effect of restricting competition within the EU. Article 82 prohibits any abuse of a dominant position within a substantial part of the EU that may affect trade between Member States. These rules are primarily enforced by the European Commission, which cooperates with the national competition authorities, and through the national courts. The Antitrust Authority has the power to apply Article 81(1) and Article 82, following its own procedures and imposing, if necessary, the fines provided for under Law 287. In September 1991, general guidelines were published by the European Commission on the application of EU Competition Law in the telecommunications sector. In August 1998, the European Commission published a notice updating the 1991 guidelines. These guidelines outline the EU's approach to common competition issues.

On December 11, 1996, the Commission adopted a Communication on the application of the competition rules to access agreements in the telecommunications sector. The purpose of this notice is:

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

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

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

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

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On December 11, 2001, the European Commission issued a Green paper on the Review of Council Regulation (EEC) No. 4064/89, concerning mergers with community dimensions. The Commission seeks to launch a wide ranging debate on the functioning of the EU merger control regime based on the experience gained during the last 10 years. On December 11, 2002, the Commission published a proposal for a Council Regulation on the control of concentrations between undertakings. The proposal tackles jurisdictional issues (such as the notion of concentration and the community dimension), substantive issues (such as the concept of dominance) and Procedural issues (such as the timing of notifications, the suspension of proceedings, etc.).

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

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

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Glossary Of Selected Telecommunications Terms

4.4 GLOSSARY OF SELECTED TELECOMMUNICATIONS TERMS

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Exchange: See Switch.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

ISPs (Internet Service Provider): A vendor who provides access to the Internet and world wide web.

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

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

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

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

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

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

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

MS SPRING: A form of traffic protection mechanism for the equipment.

MSP: The name of a general purpose programmable switch made by Redcom Laboratories.

Multimedia: A service involving two or more communications media (e.g., voice, video, text, etc.) and hybrid products created through their interaction.

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Glossary Of Selected Telecommunications Terms

Network: An interconnected collection of elements. In a telephone network, these consist of switches connected to each other and to customer equipment. The transmission equipment may be based on fibre optic or metallic cable or point to point radio connections.

NNI (Network Node Interface): The interface between two public network pieces of equipment.

NNI Agreements (Network Node Interface Agreements): Contractual agreements for the interface between two public network pieces of equipment.

Node: Topological network junction, commonly a switching center or station.

OLOs (Other Licensed Operators): Companies other than the incumbent operator which operate telecommunications systems in a national market.

ONP (Open Network Provision): Principles and conditions laid down by the EU for access to and usage of public telecommunications networks and services. A network architecture that permits telecommunications services to be offered on facilities of public operators and for equipment to be connected to such networks.

Optical fiber: A transmission medium which permits extremely high capacities. It consists of a thin strand of glass that provides a pathway along which waves of light can travel for telecommunications purposes.

OSS (Operations Support System): Methods and procedures (whether mechanized or not) which directly support the daily operation of the telecommunications infrastructure.

Outsourcing: Hiring outsiders to perform various telecommunications services, which may include planning, construction, or hosting of a network or specific equipment belonging to a company, and, ultimately, the management of entire telecommunications systems. Value-added applications may also be provided in various sectors.

PABX (Private Automatic Branch Exchange): Telephone switchboard for private use, but linked to the national telephone network.

Packet-Switched Services: Data services based on parceling or breaking the data stream into packets and switching the individual packets. Information transmitted (whether voice or data) is segmented into cells of a standardized length, which are then transmitted independently of one another, allowing maximization of available capacity and usage of a single transmission path for multiple communications. The cells are then reassembled upon reaching their destination.

Pay-Per-View: A system by which the viewer pays to see a single program (such as a sporting event, film or concert) at the moment at which it is transmitted or broadcast.

Pay TV: Paid-for TV channels. To receive Pay TV or Pay-Per-View programs, a decoder must be connected to the television set, and a conditional access system.

PCN (Personal Communications Network): PCN is a cellular telephony network designed to have the high capacity required to support a mass market service.

PCS: Personal communications services.

Penetration: The measurement of the take-up of services. As of any date, the penetration is calculated by dividing the number of subscribers by the population to which the service is available and multiplying the quotient by 100.

Platform: The total input, including hardware, software, operating equipment and procedures, for producing (production platform) or managing (management platform) a particular service (service platform).

POTS (Plain Ordinary Telephone Service): The basic telephony service supplying standard, single-line telephones, fixed-line services and access to public voice telephony network.

PSTN (Public Switched Telephone Network): The public telephone network delivering the basic telephone service and, in certain circumstances, more advanced services.

Roaming: A function that enables wireless subscribers to use the service on networks of operators other than the one with which they signed their initial contract.

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RoF (Radio over Fiber): A technology to feed antennas with digital/analogue signals over optical fiber.

Satellite services: Satellites are used, among other things, for links with countries that cannot be reached by cable or as an alternative to cable and to form closed user networks.

SDH Standard (Synchronous Digital Hierarchy): The European standard for high-speed digital transmission.

SDSL (Symmetrical Digital Subscriber Line): Also known as HDSL.

Service Provider: The party that provides end users and content providers with a range of services, including a proprietary, exclusive or third-party service center.

SGT (Transit exchange interconnection level for telephone traffic): Transit Exchange for telephone traffic carriage, routing and transmission.

SGU (Local exchange interconnection level for telephone traffic): Local Exchange for telephone traffic carriage, routing and transmission.

SME: The small- and medium-size enterprise market which consists of businesses having between 3 and 50 employees.

SNCP: A form of traffic protection mechanism for the equipment.

SOHO: The small office/home office market which consists of businesses that use telephone lines to connect to the Internet, as opposed to dedicated lines, and is made up of small businesses, generally with one or two employees, and businesses conducted out of the home.

SPP (Service Provider Portability): Allows an end user to retain the same directory number after changing from one service provider to another.

Switch: These are used to set up and route telephone calls either to the number called or to the next switch among the path. They may also record information for billing and control purposes.

Switched Transit Traffic: Calls placed between two other countries that are routed through the Italian fixed network.

Synchronous: Type of data transmission in which there is permanent synchronization between the transmitter and the receiver.

TACS (Total Access Communication System): An analog cellular network using the 900 MHz band based on a European standard also used in the UK, Ireland, Austria and Spain. Features include handover and available add-on services include answering, call notification, call transfer, differentiation of business and private calls, authorization code for outgoing international calls and itemized billing.

UMTS (Universal Mobile Telecommunication System): Third generation mobile communication system.

Universal service: The obligation to supply basic service to all users throughout the national territory at reasonable prices.

VAS (Value Added Services): Value Added Services provide a higher level of functionality than the basic transmission services offered by a telecommunications network for the transfer of information among its terminals, which include wired or wireless switched-circuit analog voice communications; direct unrestricted digital point-to-point service at 9,600 bit/s; packet switching (virtual call); direct broadband analog transmission of TV signals, and supplementary services, such as closed user groups; call waiting; collect calls; call forwarding, and identification of number called. Value Added Services performed by the network, the terminals or the specialized centers include message handling services (MHS) (which can be used, among other things, for commercial documents in predetermined formats); electronic directories listing users, network addressees and terminals; e-mail; fax; teletex; videotex and videotelephone. Value Added Services could include also value added voice telephony services such as Freephone or Premium Rate Services.

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Glossary Of Selected Telecommunications Terms

VAN (Value-added Network): A type of public network that leases basic transmission facilities from a common carrier, adds features that enhance the service and provides the improved communications capability to end users. Automatic alternate routing network management and error correction are examples of the value added.

Videotex: A service pursuant to an ITU standard, permitting remote access to a database by telephone.

VPN (Virtual Private Network): A network designed for a business or government agency, using the infrastructures of a carrier and providing customized services, and which operates in such a manner as to appear dedicated to the user thereof.

WAN (Wide Area Network): A private network that covers a wide geographic area using public telecommunications services.

WAP (Wireless Application Protocol): A technology which allows access to the Internet using mobile sets, even without the use of a computer.

WI FI: A service for wireless Internet connection and high speed access.

WLL (Wireless Local Loop): The means of configuring a local loop without the use of wiring.

XSDL ((generic) Digital Subscriber Line): A generic term for DSL equipment, services and technologies which provide extremely high bandwidth over the twisted-pair lines that run from a phone company's central office to a home or office.

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4.5 DESCRIPTION OF PROPERTY

General

As of December 31, 2004, the Telecom Italia Group owned approximately 6,700 buildings located throughout Italy. Specialized buildings for telecommunications services account for the majority of properties both in number and book value. They house mainly exchange equipment and transmission equipment, and are used as part of the Telecom Italia Group's continuing telecommunications operations. General purpose properties consist chiefly of offices, depots and computer centers.

The principal categories of the Telecom Italia Group's equipment are exchanges and transmission equipment, cable networks, base stations for cellular networks and equipment for radio communications, most of which are located throughout Italy. The Telecom Italia Group also has numerous computer installations which are primarily located at the headquarters of the Telecom Italia Group's significant subsidiaries.

At December 31, 2004, telecommunications installations, including local and domestic long distance networks and radio transmission equipment, represented approximately 80% of the tangible assets of the Telecom Italia Group, land and buildings represented 10%, plant under construction, advances to suppliers and stock for tangible assets represented 5%, and furniture, office equipment and other equipment, technical installations and machinery comprised the remaining 5%.

As of December 31, 2004, the total amount of liens, mortgages and pledges on real property owned by the Telecom Italia Group was \$99 million. Such liens, mortgages and pledges do not represent major encumbrances on tangible assets and on the material plans to expand or construct new facilities.

An important element of Telecom Italia's restructuring plan was to realize value on its extensive real estate portfolio.

In November 2000, Telecom Italia established a partnership with Beni Stabili, a leading Italian real estate operator, and Lehman Brothers to manage a significant portion of Telecom Italia's real estate portfolio.

Telecom Italia contributed a going concern including an important portion of its real estate portfolio to IM.SER and subsequently sold 45% of this company to Beni Stabili and 15% to Lehman Brothers.

The real estate portfolio originally held by IM.SER consisted of 581 properties, totaling 3.7 million square meters and was composed of two parts, the Real Estate Investment Portfolio and the Real Estate Trading Portfolio :

- Real Estate Investment Portfolio , consisting of 386 properties totaling approximately 2.4 million square meters, located throughout Italy. All the properties, including buildings that contain telecommunications equipment, were leased to Old Telecom Italia at the end of 2000 under long-term lease contracts (21 plus 6 years) at market rates; and
- Real Estate Trading Portfolio , consisting of 195 properties totaling approximately 1.3 million square meters, located throughout Italy. Of these properties, the majority have been leased at market rates to Old Telecom Italia under contracts allowing for early termination in favor of Telecom Italia.

In May 2001, IM.SER contributed its Real Estate Trading Portfolio to Telemaco Immobiliare, a newly formed company. Following such contribution, IM.SER sold the shares of Telemaco Immobiliare to its shareholders. The shareholders of Telemaco Immobiliare at that time were Beni Stabili with a 45% stake, Telecom Italia with a 40% stake and Lehman Brothers with a 15% stake.

On May 16, 2001, Beni Stabili exercised an option to buy the Lehman Brothers stake in IM.SER, resulting in Beni Stabili holding a 60% stake in IM.SER and Old Telecom Italia a 40% stake.

Since 2002 certain additional real estate related transactions were completed:

Tiglio Project

Pursuant to a framework agreement signed in May 2002, between the Pirelli, Olivetti-Telecom Italia Groups and The Morgan Stanley Real Estate Funds (through MSMC Italy Holding B.V. and POPOY Holding B.V.) certain real

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Description Of Property

estate properties as well as the entities that provide real estate services to the same companies or to their subsidiaries were transferred to two new vehicle companies set up for this purpose (Tiglio I S.r.l. and Tiglio II S.r.l.).

Among the preliminary transactions for the concentration of the real estate assets in Tiglio I and Tiglio II, on October 24, 2002, the non-proportional partial spin-off of IM.SER (60% Beni Stabili and 40% Telecom Italia) was effected by which the relative real estate assets were contributed to the company IM SER 60 (98% Beni Stabili group and 2% Telecom Italia) and to the company EMSA Immobiliare (100% controlled by Telecom Italia) in proportion to the stakes held in IM.SER, respectively, by Beni Stabili and Telecom Italia.

Following this transaction, which came after the completion of the securitization of IM SER 60's debt, and also to the effect of certain tangible asset acquisitions by companies in the Seat Pagine Gialle group, EMSA Immobiliare had a portfolio of 169 real estate properties.

On October 29, 2002, having satisfied the necessary conditions, a series of acts were finalized whereby the first stage of the Tiglio Project was concluded including the following:

- the subscription, simultaneously with all the other participants, to a capital increase by Tiglio I for cash, with the consequent stake in the company equaling 36.85% (in addition, at Old Telecom Italia Group level, to the 2.1% subscribed to by Seat Pagine Gialle), in proportion to the value of the assets transferred by Old Telecom Italia (and by Seat Pagine Gialle) to Tiglio I to the total assets that were taken over by the latter company;
- the subscription to a capital increase by Tiglio II paid for in kind by the contribution of Old Telecom Italia's Asset Management business segment with the consequent stake in the company equaling 49.47%;
- the sale of the investment in EMSA Immobiliare to OMS2 (100% controlled by Tiglio I);
- the sale directly and through the subsidiary Saiat of the investment in Telimm S.r.l. to the company MSMC Immobiliare Holding (entirely controlled by Tiglio I).

With reference to the part of the Tiglio Project regarding the optimization of the service activities, in November 2002, Telecom Italia sold its Property Management, Project Management and Agency businesses to the Pirelli & C. Real Estate group.

The above mentioned transactions gave rise to a total gross capital gain for the Telecom Italia Group of 234 million.

Finally, as agreed between the parties, December 24, 2002, marked the completion of the merger by absorption, in Tiglio I and Tiglio II, of the real estate investment holdings owned by them falling under the Tiglio Project and already 100% controlled, directly or indirectly; resulting in the optimization of the corporate structure of the two companies, in view of the successive actions to

leverage the assets on the market.

In particular, the second stage of the Tiglio Project consisted of the change of asset ownership, through awarding it to real estate funds, or through completion of certain transfers. The real property has been divided into several categories (office, industrial portfolio, trading portfolio, etc.), in order to optimize Tiglio I and Tiglio II shareholders' profit, and also into take account the of real estate funds' market features.

Under the second stage of the Tiglio project, 2004 marked the successful placement on the market of the following real estate funds:

- TECLA FONDO UFFICI placement closed on March 1, 2004. The Fund consisted of a contribution on the part of Tiglio I (45.70%-owned by Telecom Italia) of a real estate portfolio including 65 properties for a total market value of approximately 926 million, to which a 15% discount was applied by virtue of their transfer en masse, in addition to a contribution of 25 million in cash. The total offer, net of indebtedness equal to 60% of the value contributed, amounted to 288 million, of which 10% was kept by Tiglio I, 2% was subscribed by Pirelli & C Real Estate Società di Gestione del Risparmio S.p.A. as manager of the fund, while the remaining 88% was entirely placed on the market.

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- CLOE FONDO UFFICI placed on the market on June 29, 2004. The Fund consisted of 39 properties contributed by Tiglio I for a market value equal to some 877 million, to which a 15% discount was applied by virtue of their transfer en masse. The total offer, net of a financial indebtedness equal to 60% of the value contributed, amounted to approximately 298 million, of which 5% was subscribed by Pirelli & C Real Estate Società di Gestione del Risparmio S.p.A. as manager of the fund, while the remaining 95% was entirely with Italian investors (approximately 70%) and with foreign investors (approximately 30%).
- OLINDA FONDO SHOPS placement offered to both qualified investors and the public closed on December 6, 2004. The Fund was officially listed on December 9, 2004. The company Tiglio II contributed three properties which did not originate from and were not used by the Telecom Italia Group. A total of 42 properties were contributed to the Fund, all of which have a commercial use or can be converted to such use, for a market value of over 562 million. The offer also called for inflows of financial resources earmarked for the purchase of two entertainment centers which took place in December 2004. After these purchases, the Olinda Fund consists of 44 properties with market value of approximately 742 million. The value of the Fund is approximately 261 million.
- CLARICE LIGHT INDUSTRIAL placement with qualified investors on December 16, 2004. The Fund consisted of 27 properties transferred by Tiglio I and 43 properties transferred by Tiglio II, for a total market value of 221 million, to which a 9% discount was applied by virtue of their transfer en masse. The contribution value was thus equal to 201 million and the value of the fund, after taking into account financial indebtedness of approximately 55% of the contribution value, was approximately 90 million. The Fund was entirely placed with European investors.

Subsequent to these transactions, in 2004, Tiglio I and Tiglio II proceeded to distribute cash to the shareholders in the form of a reimbursement of capital (additional paid-in capital) and the repayment of loans. For the Telecom Italia Group, total receipts were approximately 104 million, of which 79 million was from Tiglio I and 25 million from Tiglio II.

Ortensia Project

On December 24, 2002, Telecom Italia and the other shareholders of Tiglio I (MSMC Italy Holding BV, Olivetti, Seat Pagine Gialle and Pirelli) and Tiglio II (POPOY Holding B.V.) formalized a binding agreement with the company Marzotto which became effective on March 4, 2003 to set up a common vehicle company (Ortensia s.r.l. , later called Aree Urbane s.r.l.) for the lands owned by Tiglio I and Tiglio II together with the portfolio of areas owned, directly and indirectly, by Marzotto. The agreement called for the deal to be finalized in 2003 through the spin-off of the land owned by Tiglio I and Tiglio II and other assets and liabilities related thereto to a company in which Marzotto, at the end of December 2002, on the basis of formalized agreements, had contributed a business segment inclusive of the lands earmarked for the initiative.

On July 21, 2003, the definitive spin-off agreements of Tiglio I and Tiglio II in Aree Urbane s.r.l. were formalized between the shareholders: after this operation, Telecom Italia owns 31.65% of the share capital of Aree Urbane s.r.l. and Telecom Italia Media owns 0.97%.

Dedalo Project

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In January 2003, the procedures were completed for the early purchase of 12 property units (representing about 300,000 square meters) from Teleleasing S.p.A. that are used by Telecom Italia S.p.A. and other Telecom Italia Group companies under lease contracts. The deal involved a total financial payment of approximately 369 million for the entire Old Telecom Italia Group.

Following a binding offer by the Beny Steinmetz Group through its subsidiary 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; Telecom Italia agreed to sign lease agreements on the same units to guarantee their utilization.

On June 30, 2003, all property units which were the object of the binding offer were transferred into a vehicle company, FMP Italy, former Ireos S.p.A. 100% owned by Telecom Italia. On July 21, 2003, the entire FMP Italy

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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.

Integration of the Facility Management Activities Owned by Olivetti and by Pirelli & C. Real Estate

In accordance with the agreements regarding the Tiglio Project, the Facility Management activities owned by Olivetti Multiservices and by Pirelli & C. RE Facility Management were integrated in the first half of 2003. The deal involved the transfer of 809,946 Pirelli & C. Real Estate treasury shares (just under 2% of share capital) to Olivetti which contributed the above activities concentrated in a specific company known as OMS Facility.

The transaction also calls for a possible differential to be determined on December 31, 2005 based upon the price performance of Pirelli & C. Real Estate shares.

Fintecna Project

In the beginning of December 2003, Telecom Italia formalized a lease agreement on some property units of Fintecna S.p.A.: in this agreement Telecom Italia also can exercise an option to buy all property units during the first half of 2004, for a total amount of 72 million, whereas Fintecna S.p.A. can exercise an option to sell to Telecom Italia the same units during the second half of 2004 for the same amount.

On December 22, 2003, Fintecna S.p.A. accepted the agreement.

On January 16, 2004, Telecom Italia S.p.A. and Fintecna S.p.A. signed contracts for the lease of seven buildings owned by Fintecna S.p.A., as well as a contract containing reciprocal options for the purchase and sale (put / call) of the buildings for a total of 72 million.

On June 22, 2004, Telecom Italia S.p.A., after exercising the option in April 2004, signed the deed for the purchase of the seven properties owned by Fintecna S.p.A. for the contractually agreed price. On the same date, Telecom Italia ceased lease payments for these buildings.

Facility Management (Kings Project)

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In 2004, under the policy to optimize the processes associated with Facility Management activities the following operations took place:

- On January 1, 2004 the Facility Management business segment of the company Finsiel was incorporated by Emsa Servizi S.p.A.. This transaction followed the sale of the Facility Management business segments of TIM and IT Telecom to Emsa Servizi S.p.A. on December 1, 2003.
- On February 27, 2004, Telecom Italia and Emsa Servizi signed a contract for the sale of their respective Document Management business segments to Telepost S.p.A., a newly established company, in which stakes are also held by TNT Mail, Pirelli Real Estate Facility Management and Comdata. Telepost specializes in Document Management operations (management and distribution of incoming and outgoing correspondence, archive management, etc.). On the same date, Telecom Italia and Emsa Servizi signed a contract with Telepost, with effect from March 1, 2004, whereby the latter company will distribute services connected with Document Management activities.
- On October 28, Telecom Italia and Emsa Servizi signed a contract for the sale to MP Facility S.p.A. (50% joint-venture by Pirelli & C. Real Estate Facility Management S.p.A. and by Manutencoop Facility Management S.p.A.) of their Maintenance and Environmental Services business segments. The total consideration for Telecom Italia and Emsa Servizi was equal to 70,000 and 30,000, respectively. On the same date the companies subscribed the contract for services assignment in outsourcing by MP Facility S.p.A. The operation was effective from November 1, 2004.
- On December 21, 2004 a business segment of Emsa Servizi S.p.A. was transferred to Telecom Italia. This operation was effective from January 1, 2005. The services provided by Emsa Servizi until this date will be provided by Telecom Italia facilities managing centralized services.

Furthermore, in May 2004 the call center services for Telecom Italia Information Technology and Finsiel as well as for Telecom Italia and Emsa Servizi customers were transferred to the Wireline Business Unit. The transfer took place through a transfer of employees engaged with those activities.

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Item 5. Operating And Financial Review And Prospects

General Factors Affecting The Telecom Italia Group s Business

Item 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS

The following discussion should be read in conjunction with the Consolidated Financial Statements included elsewhere in this Annual Report. Such financial statements have been prepared in accordance with Italian GAAP, which differ in certain material respects from U.S. GAAP. For a discussion of the principal differences between Italian GAAP and U.S. GAAP as they relate to Telecom Italia, see Note 27 of Notes to Consolidated Financial Statements included elsewhere herein.

5.1 GENERAL FACTORS AFFECTING THE TELECOM ITALIA GROUP S BUSINESS

5.1.1 THE EUROPEAN AND THE ITALIAN MARKET FOR TELECOMMUNICATIONS SERVICES

In 2004, the Western European telecommunications carrier services market grew by 3.6%; a 3.5% growth rate is expected in 2005, despite an expected decrease in revenues in the fixed voice telephone services (source: Eito 2005). Eito, or European Information Technology Observatory, is a non profit organization sponsored by telecommunications operators (including Telecom Italia) and information technology companies and supported by the EU and the OECD.

In 2004, the Italian telecommunications carrier services market grew by 3.9% (source: Eito 2005). 32% of total market revenues was generated by fixed line telephone services, 53% by mobile telephone services and 15% by fixed data services (Internet access included) (source: Eito 2005). This contrasts with 34%, 52% and 14%, respectively, in 2003.

As in previous years, the growth in demand for telecommunications carrier services continues to be driven by mobile telephone services and by the development of broadband Internet access.

Italy is one of the European countries with both the highest mobile penetration rate and the absolute number of subscribers; only Germany has a higher absolute number of mobile users (source: Eito 2005). Italy is a leader among European countries in terms of availability and the spread of third generation or 3G services. The new entrant (H3G) launched UMTS services in March 2003.

UMTS technology was launched by TIM in 2004.

In 2004, approximately 28 million people in Italy used the Internet (source: Eito 2005). Internet usage growth has been sustained by increased penetration of broadband services, led by the commercial success of ADSL.

Over the next two years, the Italian telecommunications carrier services market is expected to grow slightly above Western European average, with a growth rate of 4.6% in 2005 and 4.0% in 2006 (source: Eito 2005). Growth is expected to be driven by fixed data services (which includes broadband Internet access) and mobile telephone services.

5.1.2 COMPETITION

Competition

The Telecom Italia Group faces domestic competition in all of its businesses. See Item 4. Information on the Telecom Italia Group 4.1 Business 4.1.8 Updated Targets and Strategy and Item 4. Information on the Telecom Italia Group 4.2 Business Units 4.2.9 Competition . Management expects further consolidation among telecommunication services suppliers, especially at a national level.

On the technological side, innovation will be aimed at offering broadband services with faster connections in the fixed line market and in the development of seamless solutions for the wireless market. The incumbent operators will focus their strategic plans on the introduction of new broadband value added services, on the defense of their domestic core businesses, and on the strengthening of their financial position through debt control.

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Competition remains a significant factor in how our businesses develop. Competitive pressure in the Italian market continued during 2004 as reflected in:

- further pressure on tariffs;
- further development of broadband service offers based on fiber optic and ADSL; and
- development of unbundling of the local loop and shared access with approximately 760,000 lines handed over to OLOs.

In order to better face the competition, in March 2004 FreeMove, the international alliance between TIM, Orange, Telefonica Moviles and T-Mobile, was launched and during 2004 it gave evidence of successful simplified and attractive offers.

5.1.3 REGULATORY ENVIRONMENT

For details please see Item 4. Information on the Telecom Italia Group 4.3 Regulation .

5.1.4 TARIFF REBALANCING

We commenced rebalancing our 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 us, as the incumbent operator in markets with a low level of competition. 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 we may charge for voice services for the four year period 2003-2006. Such price caps cover:

- basic subscriber charges and other access charges RPI (Retail Price Index) + 0%, as well as a sub-price cap for residential subscription charges of RPI RPI;
- local and out-of-district calls with a cap equal to RPI-RPI; and

- fixed to mobile traffic (limited to Telecom Italia retention for the fixed segment of the call) with a cap equal to RPI-6%.

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

Consistent with the new price-cap mechanism, Telecom Italia continued to simplify its pricing structure during the course of 2004. The general effect of the new price cap formulas for 2004 provided for an increase of 1.2% (an increase of 55 million per year) in Telecom Italia's access service charges (i.e. monthly subscription fees) and a decrease in Telecom Italia's domestic traffic charges (due to a decrease in fixed to mobile traffic expenditure of approximately 17 million). The changes in tariffs implemented in year 2004 increased business monthly subscription fees by 2.5%.

Greater pricing flexibility has been important to Telecom Italia's ability to remain competitive with respect to the telecommunication services for which there has been the greatest competition (for example, high spending customers), and it remains an essential element of Telecom Italia's strategy to be able to price services selectively in order to respond to competition by lowering prices on selected services.

See Item 4. Information on the Telecom Italia Group 4.2 Business Units 4.2.1 Wireline Traffic and Tariffs , Item 4. Information on the Telecom Italia Group 4.2 Business Units 4.2.1 Wireline Traffic and Tariffs International Traffic and Item 4. Information on the Telecom Italia Group 4.3 Regulation 4.3.6 Tariff and Pricing Policy .

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Item 5. Operating And Financial Review And Prospects

Specific Factors Which Impacted Results Of Operations Over

The 2002-2004 Period

5.2 SPECIFIC FACTORS WHICH IMPACTED RESULTS OF OPERATIONS OVER THE 2002-2004 PERIOD

5.2.1 DIVESTITURES AND COST REDUCTION PLAN

Our investment strategy in 2004 demonstrated our focused international approach with continued emphasis on certain geographical areas. Furthermore, we continued to divest from countries where we did not enjoy a leadership position. We intend to reinforce our approach, focusing on markets which we believe offer strong growth potential and where Telecom Italia Group has achieved a significant competitive foothold. We also intend to exploit opportunities coming from businesses that can be developed on an European scale (such as broadband).

As part of the ongoing review of operations, during the first months of 2005 we announced the disposal of other non-core assets (see Item 4. Information on the Telecom Italia Group 4.1 Business 4.1.6 Recent Developments during 2005).

The results achieved through efficiency gains and the disposals plan have strongly impacted Telecom Italia Group's net financial debt (see Item 3. Key Information 3.3 Selected Financial and Statistical Information for a reconciliation of gross debt to net financial debt over the past three years).

Efficiency gains in operating and capital expenditures amounted to 771 million in 2004 reaching in the three year period ended December 31, 2004 3,021 million of cost savings (over the 2002-2004 announced target of cost reductions of 2.6 billion). From September 2001 to December 31, 2004 net financial debt decreased by approximately 13.9 billion (from 43.4 billion to 29.5 billion). The macroeconomic components which determined this reduction were cash flows generated by operations, divestitures of tangible assets and long-term financial investments and distributions to shareholders (dividends, withdrawals and the tender offers by Olivetti for Old Telecom Italia shares) for approximately 13 billion in the three year period ended December 31, 2004.

5.2.2 PROVISIONS AND WRITE-DOWNS AND GAINS ON DISPOSAL OF EQUITY INVESTMENTS, TANGIBLE AND INTANGIBLE FIXED ASSETS OF NON RECURRING NATURE

Our results of operations in 2002 were disproportionately impacted by the ongoing disposal program of non-core assets, as mentioned below, and the ongoing review of operations that occurs throughout the year.

Starting in 2001, with the change in management through Olimpia, we undertook a significant review of all operations, including the assessment of each operation's long-term viability within the Telecom Italia Group framework and the related fair value of that operation. The review conducted since 2001 indicated that, due to the acquisition of many of these assets in prior years at relatively high valuations, the valuations of these assets could no longer be supported by market fundamentals. The following table outlines the extent to which asset impairments, generally related to goodwill, occurred:

	Year ended December 31,		
	2002	2003	2004
	(millions of euro)		
Provisions and write-downs of goodwill and equity investments	(6,584)	(879)	(581)
Gains on the disposals of equity investments, tangible and intangible fixed assets	2,553	105	190

In 2004, provisions and write-downs of goodwill and equity investments amounted to 581 million. In 2004, write-downs of goodwill were mainly taken for Finanziaria Web and Entel Chile.

In 2003, impairments principally related to the goodwill of Telecom Italia Media, Entel Chile, Digital, and EPIClink.

In 2002, provisions were taken for the equity investment in Avea in Turkey (formerly Aria Is TIM), Seat Pagine Gialle and Digital. The Seat Pagine Gialle provision included the accrual of 1,942 million to account for the fact that, upon the disposal of SEAT, we would be required to buy out the put and call arrangements with JP Morgan and take possession of the underlying SEAT shares.

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Specific Factors Which Impacted Results Of Operations Over

The 2002-2004 Period

In 2004, gains on the disposals of equity investments, tangible and intangible fixed assets amounted to 190 million and included 85 million deriving from the sale of the entire stake held in Mirror International Holding S.a.r.l., the company to which the investments in the satellite consortia had previously been transferred.

In 2003, gains on the disposals of equity investments, tangible and intangible fixed assets amounted to 105 million.

In 2002, gains on the disposals of equity investments, tangible and intangible fixed assets amounted to 2,553 million, mostly related to the disposal of the Spanish equity investment Auna (1,245 million), the equity investment in Bouygues Decaux Télécom (484 million), the equity investment in Austrian mobile operator Mobilkom (115 million), the disposal of the interest in real estate company Telemaco Immobiliare (110 million), the transfer of selected real estate assets to Tiglio I and II (a total of 219 million), the acceptance of the tender offer for Lottomatica shares (240 million) and other minor disposals. The disposals in 2002 were part of the 2002-2004 business plan disposal of non-core assets which has continued throughout the period under review.

5.2.3 TELECOMMUNICATIONS (TLC) LICENSE FEE

The impact of certain decisions regarding the TLC License fee had a material impact on our 2003 and 2004 results of operations.

After the ruling by the Court of Justice of the European Community stating that the telecommunications license fee established by Italian Law No. 448/1998, Art. 20, is contrary to EU law, the Telecom Italia Group stopped recording the license fee for 2003 and the financial charges accrued in 2003 on the amount payable for the license fees recorded in previous years. In addition, the 2003 statement of operations benefited from the reversal of payables and reserves for risks and charges of 1,465 million for the years 2000, 2001 and 2002. Such amount, net of the tax effect of 562 million, contributed to the improvement in net income before minority interests for the year 2003 of 903 million.

Moreover, the 2004 statement of operations benefited from prior period income of 621 million relating to the TLC fee paid in 1999 as a result of the decision handed down by the TAR of Lazio No. 47/2005 of January 4, 2005 which upheld the appeal filed by Telecom Italia and cancelled the Ministerial Decree dated March 21, 2000 regarding the TLC fee instituted by Law No. 448/1998 declaring it to be illegal. Such amount, net of the tax effect of 230 million, contributed to the improvement in net income before minority interests for the year 2004 of 391 million.

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Significant Trends Impacting Our Core Businesses

5.3 SIGNIFICANT TRENDS IMPACTING OUR CORE BUSINESSES

As described above under 5.1 General Factors Affecting the Telecom Italia Group's Business, management has identified the following key trends that have, and will continue to have, an impact in our two main business areas.

Wireline

- Continuing defense of core traffic and access businesses with stabilization of traffic market share.
- Strong development of new value added services (Voice VAS and Web Services) and handsets (Aladino family and Videophone) contributing to a stabilization in voice revenues.
- Slowly decreasing voice traffic volumes, due in part to fixed to mobile substitution.
- Strong growth of Italian broadband market with significant increase of the Wireline Broadband access portfolio.
- Consolidation of the European broadband project with growth of revenues and customer base in selected European countries, including France and Germany.

Mobile

- Continuing strong competition.
- Stable customer base.
- Significant growth in value added services driven by the introduction of new technologies/new handsets and by a higher customer demand.
- Growth in targeted international markets, particularly Brazil.

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Critical Accounting Policies

5.4 CRITICAL ACCOUNTING POLICIES

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with Italian GAAP. Our reported financial condition and results of operations are sensitive to the accounting methods, assumptions and estimates that underlie the preparation of our financial statements. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The selection and application of the accounting policies by us, the judgments and other uncertainties affecting application of those policies and the sensitivity of reported results to changes in conditions and assumptions of management are factors to be considered when reviewing our consolidated financial statements. We believe the following critical accounting policies described below involve the most significant judgments and estimates used in the preparation of our consolidated financial statements under Italian GAAP.

We are also required to select accounting principles for the annual reporting of our U.S. GAAP results. Included in the following discussion are the U.S. GAAP principles we have identified that have the potential to generate significant differences from Italian GAAP and for which management is required to make substantial estimates and assumptions.

5.4.1 REVENUE RECOGNITION

Our primary revenue streams consist of fixed line telecommunication services, mobile telecommunication services, the sale of products including primarily telecommunication (both fixed and mobile) equipment and office products, IT software and services, advertising services, and Internet access and related services.

Revenues related to fixed line and mobile telecommunication services, principally network access, long distance calls, local and wireless airtime usage, are recognized when the services are provided based on the actual minutes of traffic provided and the contracted fee schedule with the customer. Certain revenues derived from telecommunication services, such as installation and activation fees are recognized at the date of installation or activation. Revenues billed in advance are deferred and recognized at the date the related service is provided.

Revenues from the sale of products, including telecommunication equipment and office products, are recognized when title transfers to the customer, which is either at the date the products are shipped or when the products are delivered and accepted by the customer.

IT services and software revenues are recognized at the date the related services are provided.

Advertising revenue from on-line services is recorded on the date the on-line advertisement is posted to the related web site. Advertising revenue from television is recorded on the date at which the advertisement is shown. Revenues from Internet access and related services primarily represent subscription services, which are recognized over the subscription period on a straight-line basis.

In connection with recording revenue, estimates and assumptions are required in determining the expected conversion of the revenue streams to cash collected. The reserve estimation process requires that management make assumptions based on historical results, future expectations, the economic and competitive environment and changes in the credit worthiness of the Telecom Italia Group's customers, and other relevant factors. If these assumptions prove to be incorrect, Telecom Italia's actual conversion rate of recorded revenue to cash may be lower than expected and we would be required to increase our allowance for doubtful accounts.

V CUSTOMER ACTIVATION FEES

We receive certain installation and activation revenues from new customers. Under U.S. GAAP, we defer recognition of non-refundable connection fees and other initial fees and recognize these over the estimated customer relationship period. We also defer the associated direct expenses over the estimated customer

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relationship period in an amount equal to or less than the amount of deferred revenues. If the length of the estimated customer relationship period increases or decreases, the amounts of deferred revenue and deferred expense is adjusted over the revised estimated life.

V MULTIPLE-ELEMENT ARRANGEMENTS

We have multiple element arrangements in two business segments, fixed and mobile.

We have adopted the provisions of the Emerging Issues Task Force Issue No. 00-21, Accounting for Revenue Arrangements with Multiple Deliverables (EITF 00-21) for multiple-element revenue arrangements entered into after December 31, 2003. EITF 00-21 requires that arrangements involving the delivery of bundled products or services be separated into individual component deliverables, each with its own separate earnings process. Revenue relating to the bundled contract is allocated among the different deliverables, based on their relative fair values (the relative fair value of each of the component deliverables to the aggregated relative fair value of the bundled deliverables). The determination of fair values in the fixed and mobile business is complex, because some of the components are price-sensitive and, thus, volatile in a competitive marketplace. Revisions to our estimates of these relative fair values may significantly affect the allocation of sales values among the different deliverables, affecting our future operating results.

5.4.2 ACCOUNTING FOR LONG-LIVED ASSETS

Property, plant and equipment and purchased intangible assets other than goodwill are recorded at their acquisition cost. If such assets are acquired in a business combination, the purchase price is allocated to the estimated fair value of the acquired property, plant and equipment and intangible assets. Property, plant and equipment and intangible assets are depreciated or amortized on a straight-line basis over their estimated useful lives.

Property, plant and equipment are valued at acquisition or construction cost, less accumulated depreciation. Construction costs include directly allocable costs, an appropriate allocation of material and production overhead and interest accruing during the construction related to debt specifically associated with the related construction project.

Accounting for long-lived assets and intangible assets involves the use of estimates for determining the fair value at the acquisition date for assets acquired in a business combination, and the useful lives of the assets over which the costs of acquiring these assets are charged to the statement of operations. The useful lives of long-lived assets are subject to such variables as technological feasibility, obsolescence, changes in consumer demand and strategic management decisions.

When an impairment in the value of assets occurs, nonscheduled write-downs are made. We assess the impairment of identifiable intangibles and long-lived assets whenever there is reason to believe that the carrying value may exceed the fair value and where a permanent impairment in value is anticipated. The determination of impairments of long-lived and intangible assets involves the use of estimates, which include but are not limited to the cause, the expected timing and the amount of the impairment. Impairment is

based on a broad measure of factors. In evaluating assets for impairment, we typically consider, among other things, technological obsolescence, discontinuance of services, changes in market prices, significant negative industry or economic trends, significant underperformance relative to expected historical or projected future operating results and other changes in circumstances that may indicate impairment. All of these assessments require the application of management judgment to the facts and circumstances existing at the time.

To assess impairment of property, plant and equipment and amortizing intangible assets for purpose of U.S. GAAP, we use the guidance outlined in SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets. If, based on the preceding discussion, management has concluded that impairment indicators exist, we will initially review for possible impairment by assessing the undiscounted cash flows expected to be derived from the asset or group of assets, comparing the lowest level of total expected undiscounted cash flow to the carrying value. If the carrying value of the asset or the group of assets exceeds the sum of the undiscounted cash flows, impairment is considered to exist. An impairment charge is assessed by comparing the assets fair value to the

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carrying value. Fair value can be calculated by a number of different approaches, including discounted cash flow, comparables, market valuations or quoted market prices. The process and steps required to assess the possible impairments of assets, including the identification of possible impairment indicators, assessing undiscounted cash flows, selecting the appropriate discount rate, the calculation of the weighted average cost of capital and the discounts or premiums inherent in market prices requires a substantial amount of management discretion and judgment. If actual results differ from these estimates, or if the Telecom Italia Group adjusts these estimates in future periods, operating results could be significantly affected.

5.4.3 ACQUISITION ACCOUNTING

We have entered into certain acquisitions and in the future may make additional acquisitions. We generally account for these acquisitions based on the form of the transaction. Cash exchanged for assets or shares is accounted for at its face value. However, other consideration, such as the fair value of shares exchanged (either Telecom Italia shares or other shares of Telecom Italia Group companies used to effect an acquisition) are generally not accounted for in Italian GAAP. In general, the Company uses carry over basis of the assets acquired and liabilities assumed and allocates the difference between the purchase price paid and the carry over basis to the intangible asset goodwill.

The development of a purchase price, and the subsequent allocation of that purchase price to the fair value of the assets acquired and liabilities assumed, is critical due to the long term impact on the statement of operations. To the extent that other assets (for example, tangible assets or trademarks) are identified that are amortizable over a shorter life than goodwill (for which the major part is 20 years), the allocation of that fair value through the purchase price allocation is fundamental to the statement of operations.

For purposes of our U.S. GAAP reporting, we are required to perform a purchase price allocation under SFAS 141, Business Combinations. As part of that allocation, it is necessary to develop a purchase price, which under U.S. GAAP requires that all consideration, including the fair value of exchanged shares, be valued. This purchase price, which is generally higher than that arrived at for the same acquisition using Italian GAAP, is then allocated to the fair value of the assets acquired and liabilities assumed. The allocation requires that all assets and liabilities, including those not reflected in the final financial statements of the acquired entity, be valued. This valuation approach requires that significant estimates be made. For example, in the valuation of intangible assets such as a customer list, estimates and judgment are required for the amount of expected future profitability of customers, the expected churn rates, the discount rate used to present value the earnings and the expected economic life of the asset. All of these factors, which are developed in conjunction with the guidance and input of professional third party evaluation experts, require judgment and estimates. A change in any of these estimates or judgments could change the amount to be allocated to a particular intangible or tangible asset. The resulting change in the purchase price allocation to non-goodwill assets or liabilities has a direct impact on the final amount of the purchase price that cannot be allocated to a particular asset (i.e., goodwill). Under U.S. GAAP, this allocation takes on significant meaning, as under existing U.S. GAAP (see also 5.4.4 Goodwill below), the asset goodwill is no longer a wasting asset. Therefore, as goodwill is no longer amortized on a periodic basis, the cumulative estimates and judgments made in:

- the definition of the purchase price;
- the identification of the assets acquired and liabilities assumed in the acquisition;

- the valuation of these assets and liabilities in the purchase price allocation; and
- the assessment of whether selected assets have an indefinite life or are amortizing;

has a significant impact on both the level of total goodwill and the statement of operations.

5.4.4 GOODWILL

Goodwill resulting from business combinations is amortized on a straight-line basis over its estimated useful life.

The determination of goodwill is dependent on the allocation of the purchase price to the tangible and intangible fixed assets acquired and liabilities assumed. Such allocation is often based on judgmental factors and estimates of fair values for assets that may not have a readily determinable market value. In addition, the useful life

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assigned to goodwill is an estimate based on the judgment of management at the time of acquisition. The estimated useful life is subject to adjustment if facts and circumstances indicate that the assets' economic life has been affected by other variables, including technological feasibility, competitive factors and contractual rights. During 2003, management re-assessed the goodwill that originated from the original 1999 acquisition of Old Telecom Italia. That assessment was undertaken based on the input of independent third party professionals and the valuations undertaken as part of the Merger. Based on the re-assessment, we concluded that the remaining goodwill of Old Telecom Italia, which was originally established with a life of 20 years, should be reset as of 2003 to 20 years. The effect of this change in estimate was to reduce goodwill amortization expense in 2003 by 227 million.

Nonscheduled write-downs are provided when an impairment in the value of goodwill occurs. We review on a regular basis the performance of our subsidiaries. When there is reason to believe that the goodwill arising from the acquisition of a business is impaired and that the impairment is of a permanent nature, we compare the carrying amount of that subsidiary or business to its fair value. The determination of the fair value of a subsidiary involves extensive use of estimates. Methods commonly used by us for valuations include discounted cash flow methods, comparable market multiples and quoted stock market prices, if available. Factors affecting estimated fair values typically include discount rates, future cash flows, growth rates, weighted average cost of capital, market prices and control premiums. These estimates, including the methodologies used, are important in determining fair value and ultimately the amount of any goodwill impairment.

For purposes of our U.S. GAAP reporting, we use the requirements of SFAS 142, Goodwill and Other Intangible Assets, and as a result we do not amortize goodwill and indefinite lived intangible assets. The requirements of SFAS 142 include that goodwill be tested for impairment at least annually (and between annual tests when certain triggering events occur) using a two-step methodology. The first step screens for potential impairment at the reporting unit level, while the second step measures the impairment, if any. Under U.S. GAAP, the quoted market price of an asset or other valuation techniques, including discounted cash flow, comparables, etc., are acceptable valuation methodologies to assess fair value. The selection of the various assumptions that are necessary to arrive at the fair value of a reporting unit, including the assumptions used in the underlying business plans or targets, require substantial management judgment and discretion. If actual results differ from these estimates, or if we adjust these estimates in future periods, operating results could be significantly affected.

5.4.5 DEFERRED TAXES

We are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves a jurisdiction-by-jurisdiction estimation of actual current tax exposure and the assessment of the temporary differences resulting from differing treatment of items, such as accruals and amortization, among others, for tax and financial reporting purposes. These differences result in deferred tax assets and liabilities, which are included within our consolidated balance sheet. We must assess in the course of our tax planning process the ability of Telecom Italia and its subsidiaries to obtain the benefit of deferred tax assets based on expected future taxable income and available tax planning strategies. If in management's judgment, the deferred tax assets recorded will not be recovered, a valuation allowance is recorded to reduce the deferred tax asset.

Significant management judgment is required in determining our provision for income taxes, deferred tax assets, deferred tax liabilities and valuation allowances to reflect the potential inability to fully recover deferred tax assets. In our Italian GAAP financial statements the analysis is based on the estimates of taxable income in the jurisdictions in which we operate and the period over which the deferred tax assets and liabilities will be recoverable. If actual results differ from these estimates, or we adjust these estimates in future periods, we may need to establish an additional valuation allowance which could adversely affect our financial position and results of operations.

Under U.S. GAAP, we assess the recoverability of tax assets based on the criteria of more likely than not, that is, a probability of recoverability just over 50%. Assessment of the appropriate amount and classification of income taxes is dependent on several factors, including estimates of the timing and realization of deferred income tax assets and the timing of income tax payments. Actual collections and payments may materially differ from these estimates as a result of changes in tax laws as well as unanticipated future transactions impacting related income tax balances.

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5.4.6 ALLOWANCE FOR DOUBTFUL ACCOUNTS

Management maintains an allowance for doubtful accounts to account for estimated losses resulting from the inability of our customers to make required payments. Management bases its estimates on the aging of our accounts receivable balances and our historical write-off experience with similar receivables, customer credit-worthiness and changes in our customer payment terms when evaluating the adequacy of our allowance for doubtful accounts. If the financial condition of our customers were to deteriorate, our actual write-offs might be higher than we expect.

5.4.7 ACCRUED LIABILITIES

We exercise considerable judgment in recording our accrued liabilities and our exposure to contingent liabilities related to pending litigation or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation as well as other contingent liabilities.

Judgment is necessary in assessing the likelihood that a pending claim will succeed or a liability will arise and to quantify the possible range of the final settlement. In case the occurrence of a contingency or potential liability is more likely than not, we accrue an amount for contingent liabilities that represents management's estimate at that date. Because of the inherent uncertainties in the foregoing evaluation process, actual losses may be different from the original estimated amount accrued.

For purposes of U.S. GAAP, we apply the guidance outlined in SFAS 5, Accounting for Contingencies. Under SFAS 5 a loss contingency is considered to exist when a future use of assets to settle a liability or claim is considered probable and can be reasonably estimated. The necessary estimates used by management rely on the analysis of internal specialists, attorneys, actuaries or other external specialists as considered necessary. A revision of the original estimates may significantly affect future operating results.

5.4.8 FINANCING, ACQUISITION AND LEASE TRANSACTIONS

We have entered into several financing, acquisition and lease transactions that have resulted in material off balance sheet accounting treatment. These transactions include the sale and the subsequent lease of certain real estate assets, the sale of a portion of our equity interest in certain satellite sector entities, and the sale of trade accounts receivable under a securitization program.

We have acquired several companies using the shares of listed subsidiaries as a form of currency, often in conjunction with a mix of cash. For purposes of acquisition accounting, no economic value is ascribed to the shares exchanged, therefore the recorded value of the acquired company does not reflect the value of the underlying shares given up. For purposes of U.S. GAAP, the shares of the subsidiaries used to acquire a target are fair valued as part of the purchase price, generally based on the quoted market price of the shares at the date of the announcement. As there is an economic value ascribed to these shares, the total

investment in the acquired company is generally larger, including the associated goodwill, on a U.S. GAAP basis. From 2002, as part of the adoption of SFAS 142, this goodwill is no longer amortized, but rather becomes subject to the fair value impairment tests as previously described.

The sale and the subsequent lease of certain real estate assets, the sale of a portion of our equity interest in certain satellite sector entities, and the sale of accounts receivable under securitization programs have been recorded as sale transactions and gains or losses were recognized for the differences between the fair value of the consideration received and the carrying value of the real estate assets, investments, and receivables sold. The real estate assets sold continue to be used in the ordinary course of our operations and are accounted for as operating leases. Management has substantial flexibility in structuring transactions to effect the recognition of assets, liabilities, gains and losses. For purposes of U.S. GAAP, the sale of the real estate portfolio s were not considered to be sales as we maintained a continuing interest in the properties, therefore no gains were recognized and the assets remain on the balance sheet, with the cash received treated as a secured borrowing. Similarly, the securitization of certain equity stakes in the satellite sector with a special purpose entity resulted in that structured entity also being fully consolidated in our U.S. GAAP results.

However, we have deconsolidated the qualified special purpose entity related to the accounts receivable securitization program initiated in 2001.

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In general, U.S. GAAP requires a substance over form approach to structured transactions, including real estate, leases, securitizations and other structured finance transactions. For purposes of U.S. GAAP, for entities created or modified after January 31, 2003, we adopted the financial reporting guidelines of FIN No. 46 (revised December 2003), Consolidation of Variable Interest Entities (FIN 46-R). Consolidation will no longer be determined solely on the majority of voting interests approach, but instead on identifying the primary beneficiary of the variable interest entity. The assessment of which party has the primary benefit will require management to assess each transaction in which it currently holds such financial interests, assessing the probability of expected residual returns and expected losses to arrive at a final decision regarding consolidation.

5.4.9 DERIVATIVES

We enter into several different types of derivative contracts in order to adjust and manage the various cash flows associated with foreign currency and interest rate exposures. For purposes of Italian GAAP, the changes in the fair value of the derivative contract are not accounted for in the statement of operations until the contract has expired. The notional amount of the contracts open at the end of the fiscal year is disclosed. For purposes of U.S. GAAP, we have used the guidance established in SFAS 133, Accounting for Derivative Instruments and Hedging Activities. Under U.S. GAAP, the changes in the fair value of instruments which do not qualify for hedge accounting, fair value hedges, and the ineffective portion of cash flow hedges, are recognized in the statement of operations in the period of change. The gain or loss on the effective portion of qualifying cash flow hedges is reported in Other Comprehensive Income. The assessment of the fair value of a derivative contract requires the use of quoted market prices, banker price quotations, price quotations for similar instruments traded in different markets and, where applicable, pricing models. Pricing models and their underlying assumptions impact the amount and timing of unrealized gains and losses recognized. As a result, we are required to rely on these pricing models when external fair values are unavailable. The estimates regarding future prices requires estimating several factors, including interest rates, currency values and cash flows. Prices realized in the future will differ from the estimates, therefore producing different financial results.

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Adoption Of International Accounting Standards

5.5 ADOPTION OF INTERNATIONAL ACCOUNTING STANDARDS

With effect from the 2005 fiscal year, Telecom Italia will prepare its interim and annual consolidated financial statements in accordance with IAS/IFRS.

5.5.1 EVOLUTION OF THE REGULATORY FRAMEWORK

The principal phases which characterized the process of accounting harmonization within the European Union, and in Italy in particular, are:

- the adoption of Regulation No. 1606 issued by the European Parliament and by the Council of the European Union in July 2002 which provides for the mandatory application of IAS/IFRS, beginning from 2005, for the consolidated financial statements of companies listed in regulated markets of the European Union; moreover, this Regulation accorded to the Member States the authority to permit or to require the application of IAS/IFRS also for the preparation of the annual statutory accounts of listed companies and the annual statutory accounts and consolidated financial statements of unlisted companies;
- the European Commission's adoption of Regulation No. 1725 dated September 29, 2003 which approved the international accounting standards, and related interpretations, existing at September 14, 2002; IAS 32 and IAS 39, relating to the disclosure and measurement of financial instruments, respectively, and the related interpretations (SIC 5, 16 and 17) were excluded from that approval process;
- the issue, by Italian legislators, of Law No. 306 dated October 31, 2003 (2003 EU Law) by which the Italian legislators exercised (Art. 25) the option permitted by the above-cited EU Regulation No. 1606/2002, and, accordingly, delegating the Government to adopt one or more legislative decrees implementing the authority provided by the above-mentioned EU Regulation within one year of the law coming into force (i.e. within November 30, 2004);
- the issue by Italian legislators of Legislative Decree No. 38 dated February 28, 2005 which implemented the provisions contained in the Art. 25 of the above-cited Law No. 306/2003. This decree provides that listed companies required by EU Regulation No. 1606/2002 to prepare their consolidated financial statements in accordance with IAS/IFRS may, from 2005, also draw up their annual statutory financial statements in accordance with those standards (mandatory from 2006). The possibility of applying IAS/IFRS to the unlisted subsidiaries of listed companies is also available.

In this regard, Telecom Italia and its Italian subsidiaries intend to apply IAS/IFRS for their annual statutory financial statements beginning from 2006;

- the recommendations of CESR (Committee of European Securities Regulators) published on December 30, 2003 and containing guidelines for companies listed within the EU regarding the transition to IAS/IFRS;

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- the European Commission's adoption of Regulations No. 707 dated April 6, 2004, which approved IFRS 1 First-time adoption of International Financial Reporting Standards, No. 2086 dated November 19, 2004, which approved, with certain limitations, IAS 39, and No. 2236, No. 2237 and No. 2238 dated December 29, 2004 which approved IAS 32 and the other accounting standards reviewed by the IASB in December 2003 and March 2004, the new IFRSs issued in March 2004 (with the exception of IFRS 2, approved by the European commission with Regulation No. 211 dated February 4, 2005), and the interpretation document IFRIC 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities, thereby achieving a stable system of accounting standards.

However, the version of IAS 39 approved by the EU in the above-cited Regulation No. 2086 differs from the text approved by the IASB with regard to certain aspects of the valuation of liabilities at fair value and of the macro-hedging of the interest rate risk associated with portfolios of assets and liabilities. The Telecom Italia Group applies the version of IAS 39 approved by the European Commission. However the full application of IAS 39 would not have resulted in any impacts on 2004 financial statements.

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During 2003, Telecom Italia commenced a specific project relating to the implementation of IAS/IFRS (through the establishment of a dedicated working group involving the principal companies of the Telecom Italia Group) with the final objective being the restatement, in accordance with IAS/IFRS, of:

- the opening consolidated balance sheet at January 1, 2004 (date of transition to the new accounting standards);
- the consolidated financial statements for the year ended December 31, 2004 prepared for comparative purposes only (limited to the financial statements only);
- the 2004 interim data (quarterly and first-half data) prepared for comparative purposes only.

At present, the first two steps are substantially completed while the restatement of the 2004 interim data is in progress.

Moreover, the restatement of the opening consolidated balance sheet at January 1, 2004 and of the statements of the consolidated financial statements for the year ended December 31, 2004 required the following preliminary decisions by Telecom Italia among the options provided by IAS/IFRS:

- **financial statement presentation:**
 - *Balance sheet:* IAS 1 requires the classification of assets and liabilities as current/non-current or in terms of the liquidity of the assets and liabilities. The Telecom Italia Group uses the current/non-current classification which is generally applied by industrial and commercial enterprises;
 - *Statement of income:* in accordance with IAS 1, the statement of income may be presented with expenses classified by function or by nature. The Telecom Italia Group has chosen to adopt the classification of expenses by nature;
- **principal exemptions provided by IFRS 1 upon first-time adoption of IAS/IFRS (January 1, 2004):**
 - *valuations of property, plant and equipment, investment property and intangible assets at fair value or, alternatively, at revalued cost as the deemed cost:* for property, plant and equipment the Telecom Italia Group can take advantage of the following optional exemptions:
 - to adopt the fair value of the asset at January 1, 2004, instead of the original cost, as deemed cost; or

- to adopt, on satisfaction of certain conditions, the revalued cost of the asset, instead of the original cost, as deemed cost.

These exemptions are applicable also for investment property valued at cost (IAS 40) and to intangible assets valued at cost provided that they meet the criteria required by IAS 38 for their recording. The Telecom Italia Group will utilize these exemptions and use revalued cost for certain of its assets;

- *share-based payments:* IFRS 2 is applicable to financial statements for periods beginning on or after January 1, 2005. However, earlier application of this standard is encouraged. The Telecom Italia Group applies IFRS 2 prospectively beginning from January 1, 2005; the adoption of such principle from January 1, 2004 would not have resulted in any impacts on 2004 financial statements;
- *business combinations:* should be accounted for by applying the purchase method provided by IFRS 3. For purposes of the first-time adoption of IAS/IFRS, IFRS 1 allows a company/group not to apply IFRS 3 retrospectively to any business combinations which occurred before the date of transition to IAS/IFRS (January 1, 2004). However, if any business combination which occurred before the date of transition is restated to comply with IFRS 3, all subsequent business combinations should be restated in accordance with the purchase method set out in IFRS 3. The Telecom Italia Group has chosen to adopt IFRS 3 prospectively beginning from January 1, 2004;
- *reserve for net exchange differences deriving from the translation of the financial statements of foreign operations:* in accordance with IAS 21, net exchange differences resulting from the translation of the financial statements of a foreign operation (subsidiary, affiliate, joint venture, branch) should be classified as a separate component of equity which, upon disposal of the foreign operation, will be reclassified to the statement of income when the gain/loss on disposal is recognized. IFRS 1 allows

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first-time adopters of IAS/IFRS to apply IAS 21 prospectively and therefore not to record at the date of transition the cumulative net exchange differences deriving from translations of the previous financial statements of foreign operations. The Telecom Italia Group is taking advantage of this optional exemption;

- *financial instruments recorded in accordance with previous accounting principles:* a company/group should apply IAS 39 to financial statements for periods beginning on or after January 1, 2005. Earlier application is permitted. The Telecom Italia Group has chosen to adopt IAS 32 (Financial Instruments: Disclosures and Presentation) and IAS 39 (Financial Instruments: Recognition and Measurement) from January 1, 2004;
- *designation date of financial instruments as instruments at fair value through profit or loss or as available for sale :* in accordance with IAS 39 a company/group should designate, at the time of initial recognition, a financial instrument as a financial asset or financial liability *at fair value through profit or loss* or as a financial asset *available for sale* . IAS 39 allows the possibility to make that designation at the date of transition to IAS/IFRS, and thus at January 1, 2004. The Telecom Italia Group is taking advantage of this exemption by making the designation at the date of transition;
- *derecognition of financial assets and liabilities:* in accordance with IAS 39, which amended IFRS 1, a company/group which applies IAS/IFRS for the first time should apply the derecognition of non-derivative financial assets/liabilities prospectively for financial years beginning on or after January 1, 2004. In other words, if a company/group, in accordance with its previous accounting policies, derecognized certain non-derivative financial assets and/or liabilities pertaining to transactions that occurred before January 1, 2004, it should not recognize those assets and/or liabilities in accordance with IAS/IFRS (unless they satisfy the conditions provided for recognition following a transaction or event occurring after January 1, 2004). However, a company/group may apply the derecognition of non-derivative financial assets/liabilities retrospectively from a date of the company/group's choosing, provided that the information needed to apply IAS 39 to assets and/or liabilities derecognized as a result of past transactions was obtained at the time of initially accounting for those transactions. The Telecom Italia Group intends to apply the derecognition of non-derivative financial assets/liabilities retrospectively from January 1, 2003;
- **accounting treatments chosen from the accounting options allowed by IAS/IFRS:**
 - *inventories:* in accordance with IAS 2, the cost of inventories should be determined by using the FIFO method or the weighted average cost method. The Telecom Italia Group has chosen to use the weighted average cost method for each movement;
 - *valuation of tangible and intangible fixed assets:* subsequent to the initial measurement at cost, IAS 16 and IAS 38 provide that these assets may be valued at cost (and depreciated/amortized) or at fair value. The Telecom Italia Group has chosen to adopt the cost method;
 - *valuation of investment property:* in accordance with IAS 40, a property held as an investment property should be initially recorded at cost, including incidental costs. Subsequently, that property may be valued at fair value or at cost. The Telecom Italia Group has chosen to adopt the cost method;
 - *borrowing costs:* as regards the recording of borrowing costs that are directly attributable to the acquisition, construction or production of an asset, IAS 23 provides that an entity may apply the benchmark accounting treatment, which provides for the immediate charge of borrowing costs to the income statement, or the allowed alternative accounting treatment, which provides, in the presence of certain conditions, for the capitalization of borrowing costs.

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The Telecom Italia Group has chosen to charge borrowing costs to the statement of income;

- *valuation of interests in joint ventures in the consolidated financial statements:* in accordance with IAS 31, interests in joint ventures may be accounted for using the equity method or, alternatively, using the proportionate consolidation method. The Telecom Italia Group has chosen to adopt the equity method.

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The principal differences emerging from the application of IAS/IFRS compared to Italian accounting principles are summarized as follows:

- *extraordinary items*: in accordance with IAS/IFRS items of an extraordinary nature can no longer be shown separately in the statement of income, but should be classified as ordinary items;
- *goodwill and differences on consolidation*: these items may no longer be amortized systematically in the statement of income but should be subject to a valuation, carried out at least annually, in order to identify any impairment in value (impairment test);
- *treasury stock*: in accordance with IAS/IFRS, treasury stock may no longer be recorded as an asset but should be recorded as a reduction of shareholders' equity (for the par value) and additional paid-in capital (for the excess amount);
- *principles of consolidation*: the possibility of excluding companies that are not significant in size, companies in liquidation, and those with dissimilar activities from the scope of consolidation has been eliminated; however, Special Purpose Entities created for specific transactions (including, for example, securitizations) and the shares of consolidated subsidiaries recorded as current assets should be consolidated;
- *assets purchased under finance lease contracts*: in the consolidated financial statements prepared in accordance with Italian accounting principles, the Telecom Italia Group accounts for finance leases with an option to purchase (including sale and leaseback transactions resulting in a finance lease) as a finance lease, while other types of finance leases are accounted for as operating leases. Under the latter method lease payments are recorded as expenses for the period and any gains deriving from the sale of those assets are immediately recognized in the income statement. Instead, the adoption of the finance method, applicable, in accordance with IAS 17, to all types of finance leases, results in the recording in the statement of income of interest expenses on the financed principal amount and the depreciation charges on the value of the leased assets, as well as the recognition of these tangible assets as assets and the residual debt as liabilities in the balance sheet. Furthermore, the application of the finance method also results in the deferral and amortization over the lease term of any gains or losses deriving from sale and leaseback transactions;
- *stock options*: IFRS 2 classifies stock options as share-based payments or as goods or services acquired as consideration for equity instruments; in particular, based on this standard, stock options should be valued at their fair value at the grant date, recording the cost in the statement of income with a contra-entry to increase reserves in shareholders' equity;
- *employee termination indemnities (TFR)*: Italian accounting principles require recognition of the liability for employee termination indemnities (TFR) on the basis of the nominal liability accrued to the end of the reporting period, in accordance with the statutory regulations in force; under IAS/IFRS, TFR falls under the category of defined benefit plans subject to actuarial valuation (taking into account mortality, foreseeable changes in salaries/wages, etc.) to present the present value of the benefit, payable upon termination of employment, that employees have accrued up to the balance sheet date;

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- *compound financial instruments:* in accordance with IAS 32, the value of compound financial instruments (e.g. convertible notes) should be allocated between financial liabilities and equity instruments (e.g. share purchase options);
- *derivative financial instruments:* in accordance with IAS/IFRS, all derivatives should be reflected in the financial statements at their fair value. The method of accounting for derivative financial instruments varies based on their characteristics (hedging instruments and non-hedging instruments);
- *restoration charges:* as required by IAS 37, the Telecom Italia Group must record liabilities to be incurred at the time tangible assets are abandoned as a result of a legal or constructive obligation assumed upon purchase and construction of the installations. The liabilities will be recorded at fair value, in the period in which they arise, as a balance sheet provision under provision for risks and charges, with a contra-entry to the tangible assets to which they refer; recognition in the statement of income occurs through the depreciation of the related asset over its estimated useful life;

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- *put and call options on shares:* in accordance with IAS 39, the irrevocable obligation related to the purchase of shares results in the recording of the shares to be purchased and the corresponding financial liability at the time that obligation arises;
- *discontinued operations:* IFRS 5 requires that the results of discontinued operations (operations disposed of or held for sale) be presented in the statement of income separately from those of continuing operations; similarly, the assets and related liabilities of operations held for sale should be classified separately in the balance sheet;
- *revenues:* in accordance with IAS 18, the recognition criteria should be applied separately to each transaction or, in certain circumstances, to the separately identifiable components of a single transaction, in order to reflect its economic substance and, with reference to the stage of completion of the transaction, this sometimes involves, compared to the Italian regulations in force, a deferral of revenues over the duration of the contract.

In particular, with regard to revenues from the activation of telephone services and from the recharging of prepaid cards, the connection/activation service is not an independent process of revenue generation realized at the time the service is rendered; accordingly, the related revenue must be recognized over time in line with the supply of the related services. This period should be estimated based on the expected life of the relationship with the customer. Similarly, also the costs incurred for the activation of the service and the recharging of the prepaid card (mainly direct labor costs) should be deferred and recognized in the statement of income over the expected duration of the relationship with the customer.

5.5.4 MAIN IMPACTS ON THE 2004 CONSOLIDATED FINANCIAL STATEMENTS DERIVING FROM THE ADOPTION OF IAS/IFRS

The information reported below has been extracted or derived from the information included in a specific section of the 2005 First Quarter Report under IAS/IFRS filed with the Italian regulators. Such information was prepared in compliance with IAS/IFRS, and relative interpretations, currently in force.

Based on the foregoing, the effects on the 2004 consolidated financial statements arising from the adoption of IAS/IFRS are as follows:

- an increase in operating income by 0.4 billion (from 7.2 billion to 7.6 billion), net of charges reclassified from extraordinary items under Italian accounting standards which are no longer allowed under IAS/IFRS;
- an increase in consolidated net income (for the portion attributable to the Parent Company) by 1 billion (from 0.8 billion to 1.8 billion);
- an increase in consolidated shareholders' equity (for the portion attributable to the Parent Company) by 1.1 billion (from 15.2 billion to 16.3 billion);
- an increase in net financial debt by 3.4 billion (from 29.5 billion to 32.9 billion).

In particular, the main impacts can be summarized as follows:

- *goodwill*: this item is no longer regularly amortized in the statement of operations but is subject to an impairment test at least once a year. For the fiscal year 2004 such change results in an increase of the shareholders' equity, in particular due to the increase in consolidated net income, by 1.5 billion, fully attributable to the elimination of the amortization;
- *consolidation area*: under IFRS all subsidiaries and Special Purpose Entities set up for specific transactions must be consolidated. Therefore, in accordance with such accounting treatment the Special Purpose Entity TISV (set up for securitization purposes) and the subsidiaries in liquidation were consolidated. Furthermore, a binding commitment arose at the end of 2004 to purchase TIM shares in the first months (as a financial transaction connected with the TIM Acquisition) which involved consolidating a further interest in TIM and recording a financial liability in the balance sheet at December 31, 2004 under IFRS, since under Italian accounting standards such commitments are treated as off-balance sheet items. As a consequence, such accounting changes result in an increase in net financial debt of 1.1 billion but have no significant impact on net income and shareholders' equity;

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- *factoring transactions:* the adoption of IAS 39, particularly the provisions regarding the derecognition of financial assets (accounts receivable), leads to a more restrictive interpretation of the conditions needed for recognizing the sale of accounts receivable and, consequently, an increase in net financial debt by 0.8 billion as much as the proceeds of the sale are considered a borrowing, however the impacts on the shareholders' equity and on the statement of operations are insignificant;
- *sale and lease-back transactions:* certain real estate sales completed by the Telecom Italia Group in prior years (2000-2003) with simultaneous lease-back contracts over 19-21 years, classified as operating leases according to Italian accounting principles, are classified under IAS/IFRS as sale and financial lease-back transactions. Accordingly, leased assets and the residual amount of the corresponding financial liability shall be recognized in the balance sheet, while depreciation and interest charges (instead of rentals) are recognized in the statement of operations and the gain realized at the disposal is deferred over the terms of the lease contracts. The different accounting treatment of these real estate transactions lead to an increase in net financial debt at the end of 2004 of 1.6 billion, and a decrease in shareholders' equity of 0.2 billion, including a decrease of 0.1 in net income;
- *provisions for risks and charges:* the requirements specified by IFRS entail a more restrictive interpretation of the conditions needed for recognizing these liabilities and the discount of the amounts estimated to be paid after 12 months. In particular, under IFRS the opening balance sheet at January 1, 2004 reflects a positive adjustment to the opening shareholders' equity due to the reversal of some provisions for risks and charges recognized under Italian accounting standards. This different accounting treatment results in a reduction of the shareholders' equity by an immaterial amount, including a reduction of 0.1 billion in 2004 net income under IFRS, as a consequence of the reversal of the uses of provisions recorded in the same fiscal year in the statement of operations under Italian accounting standards;
- *revenues:* under Italian accounting standards, revenues from activating telephone service and recharging prepaid cards are accounted for immediately in the statement of operations, whereas under IAS/IFRS they are treated as deferred revenues, as well as the related costs, to be amortized over the expected duration of the customer contract, with a consequent reduction of shareholders' equity as of December 31, 2004 of 0.3 billion and a reduction of 0.1 billion on 2004 net income;
- *convertible and exchangeable bonds:* under IFRS the value of these compound financial instruments must be split between the debt component and the equity option component. For bonds convertible into shares the value of the equity conversion option is classified in shareholders' equity, while for the bonds exchangeable for shares issued by other entities (Group or third parties) it is classified as a financial liability and measured at fair value at each period end. This different accounting treatment results in a reduction in net financial debt at December 31, 2004, of 0.3 billion, a decrease in net income for 2004 of 0.1 billion and an increase in shareholders' equity of 0.3 billion;
- *derivative instruments:* under Italian accounting standards these financial instruments are normally treated as off-balance-sheet items and adequately disclosed in the footnotes to the financial statements, whereas under IFRS they are recognized in the balance sheet at fair value. The different accounting treatment results in a reduction of shareholders' equity at December 31, 2004 of 0.2 billion (including an immaterial effect on net income) and an increase in net financial debt of 0.3 billion;
- *treasury shares:* under Italian accounting principles treasury shares are recognized as assets and a specific restricted reserve shall be recorded in shareholders' equity; under IAS/IFRS treasury shares shall be recognized as a reduction of shareholders' equity. Such different accounting treatment results in a reduction in shareholders' equity as of December 31, 2004 of 0.4 billion.

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5.6 RESULTS OF OPERATIONS FOR THE THREE YEARS ENDED DECEMBER 31, 2004

5.6.1 REORGANIZATION OF BUSINESS

During 2004 Telecom Italia Group continued the reorganization process that began in 2001 when, following the acquisition by Olimpia, the new management gained control and started implementing a restructuring plan.

The Telecom Italia businesses at December 31, 2004 are organized on the basis of the following Business Units or Corporate Functions.

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

Mobile. This Business Unit includes national and international mobile telecommunications businesses which are managed by TIM. Beginning in 2001 international mobile operations were consolidated and managed by TIM, through TIM International. International mobile operations are concentrated in Latin America and in the Mediterranean Basin.

During 2004 the mobile Brazilian subsidiaries were reorganized. As a result, Tele Nordeste Celular Participações S.A. was merged into Tele Celular Sul Participações S.A..

In Venezuela, consistent with the strategy to focus on operators with a national license, on July 1, 2004 TIM International acquired the minority interest in Digitel and subsequently, in November 2004 signed a memorandum of understanding with CANTV (Compañía Anónima Nacional Teléfonos de Venezuela) to sell 100% of the equity in Digitel.

South America. The Business Unit South America includes the Wireline and Mobile operations of Entel Chile and Entel Bolivia. Since March 1, 2004, the Latin America Operations division is no longer operational and the Business Units Wireline and Mobile have been charged with the responsibility for the results of the subsidiaries for which they are accountable in Latin America.

Consistent with the Telecom Italia Group's strategy to rationalize its international portfolio in order to focus on areas of strategic interest and with growth opportunities, on January 24, 2005 Telecom Italia International executed an agreement for the disposal of its 54.76 % equity stake in Entel Chile S.A. to Almendral S.A., a holding company listed on the Santiago Stock exchange in Chile.

On March 29, 2005 the closing of the transaction took place.

Internet and Media. During 2004 the Telecom Italia Media Group continued its business rationalization and focalization plan started in 2003, reflected in the continuing disposition of non-core assets and acquisitions to support core businesses. After these transactions, the Internet and Media Business Unit operates mainly in the following segments:

- **Internet.** Management of access services (ISP), with Tin.it, management and development of web portals (Virgilio with Matrix), and web services, where it occupies a leadership position in the Italian market;
- **Television.** La7 and MTV, both in the sectors of production and broadcasting of publishing content through the use of television transmission networks under concession and in the marketing of advertising space in TV programming; and
- **Office Products and Services.** Distribution of products, services and solutions for the office through Buffetti retail networks.

On April 4, 2005 the Boards of Directors of Telecom Italia and Telecom Italia Media approved the restructuring of the Telecom Italia Group's Internet business whereby Telecom Italia will acquire all of Telecom Italia Media's Internet activities. As a result of this transaction Telecom Italia Media will receive cash proceeds to expand its business as well as pay a dividend and repurchase a portion of its shares. See Item 4. Information on the Telecom Italia Group 4.1 Business 4.1.6 Recent Developments During 2005 Restructuring of the Telecom Italia Group Internet Activities .

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Information Technology Market. The Telecom Italia IT Market Business Unit brings together all the information technology companies and activities of the Group that are marketed to third parties. The Information Technology Market provides a full range of IT services, including consultancy services and systems integration.

On April 26, 2005 Telecom Italia signed a sale and purchase agreement with Al maviva Technologies, the COS Group holding company, for the sale of its entire stake (79.5%) in Finsiel S.p.A.. The execution of this agreement completes a competitive sale process for the controlling stake held by Telecom Italia in Finsiel S.p.A. and follows a preliminary agreement signed with Al maviva Technologies on February 24, 2005. The transaction is based upon a Finsiel enterprise value of approximately 164 million.

This transaction has no impact on consolidated operating results reported on below.

Information Technology Group. The IT Group Corporate Function is responsible for organizing technological innovation and service information technology activities within the Telecom Italia Group and covers the full range of information services within the Group. During 2004, the IT Group has undergone a legal reorganization whereby the legal entities which previously managed these activities have been merged into Telecom Italia and TIM. This reorganization occurred as part of a plan to rationalize the allocation of resources and technology skills and to simplify both business and administrative management.

Olivetti Tecnost. Olivetti Tecnost (recently renamed Olivetti) and its subsidiaries (the Olivetti Group) operate in the sector of ink-jet products for the office and digital printing systems, the development and production of products associated with silicon technology (ink-jet print-heads and MEMS) and provides specialized applications for the banking field and commerce and information systems for gaming and lottery management.

In addition, the Olivetti Group operates with Nuove Iniziative Canavese in document management services and fixed and cell phone repair.

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

For a complete description of these Business Units/Corporate Functions, see Item 4. Information on the Telecom Italia Group 4.2 Business Units . For purposes of the following discussion selected financial data of each Business Unit/Corporate Function has been provided for 2002, 2003 and 2004, consistent with the structure of each Business Unit/Corporate Function at December 31, 2004. As noted below, none of the above changes had a material impact on the 2004 results.

5.6.2 CHANGE IN SCOPE OF CONSOLIDATION AND CURRENCY EXCHANGE RATES

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Our results of operations fully consolidate all Italian and foreign subsidiaries in which we hold, directly or indirectly, more than 50% of the voting stock or have dominant influence (effective control).

Other entities in which we hold, directly or indirectly, between 20% and 50% of the voting rights, including jointly controlled companies, are accounted for under the equity method. These include a number of our international investments. The equity in the earnings of such entities (i.e., our proportional share in the profits or losses of these entities) is included in financial expense. See Note 22 of Notes to the Consolidated Financial Statements.

The following main changes in the scope of consolidation took place during the three year period 2002-2004:

- no significant changes in the scope of consolidation occurred in 2004;
- some investments were disposed of in 2003 and in particular the New SEAT group following the 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. ; such sale occurred on August 8, 2003 and therefore the activities disposed of were consolidated in the results of operations only for the first seven months of 2003; and
- some investments were disposed of in 2002 and were consolidated in the results of operations as follows: the 9Télécom group for the period from January 1, 2002 to June 30, 2002; the former Satellite Business Unit (the Telespazio group) for the period from January 1, 2002 to September 30, 2002 and the company Sogei for the period from January 1, 2002 to June 30, 2002.

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Throughout the discussion which follows we use the term "organic growth". Organic growth means that the percentage changes provided assume that on a year to year comparison basis the effects of changes in the scope of consolidation are excluded and exchange rates are calculated on a constant currency basis. Constant currency means that the difference in exchange rates between years are eliminated by using the same exchange rate.

The historical results for the year ended December 31, 2004 are presented, while the results for 2003 have been adjusted to reflect changes in the scope of consolidation and to eliminate exchange rate effects. The following table reconciles 2003 historical figures to 2003 adjusted figures to show organic growth from 2003 to 2004 for operating revenues and operating income.

	2004 (A)	2003 (B)	Growth	
			Amount (A-B)	%
(millions of Euro, except percentages)				
Operating Revenues on a historical basis	31,237	30,850	387	1.3
Changes in Exchange rates		(175)		
Changes in the scope of consolidation <i>of which from New Seat PG</i>		(895) (703)		
Operating Revenues on a comparable basis	31,237	29,780	1,457	4.9
Operating Income on a historical basis	7,200	6,789	411	6.1
Changes in Exchange rates		(4)		
Changes in the scope of consolidation <i>of which from New Seat PG</i>		(195) (166)		
Operating Income on a comparable basis	7,200	6,590	610	9.3

The historical results for the year ended December 31, 2003 are presented, while the results for 2002 have been adjusted to reflect changes in the scope of consolidation and to eliminate exchange rate effects. The following table reconciles 2002 historical figures to 2002 adjusted figures to show organic growth from 2002 to 2003 for operating revenues and operating income.

	2003 (A)	2002 (B)	Growth	
			Amount (A-B)	%
(millions of Euro, except percentages)				
Operating Revenues on a historical basis	30,850	31,408	(558)	(1.8)
Changes in Exchange rates		(728)		
Changes in the scope of consolidation <i>of which from New Seat PG</i>		(1,375) (696)		

Operating Revenues on a comparable basis	30,850	29,305	1,545	5.3
Operating Income on a historical basis	6,789	6,058	731	12.1
Changes in Exchange rates		32		
Changes in the scope of consolidation <i>of which from New Seat PG</i>		(219) (253)		
Operating Income on a comparable basis	6,789	5,871	918	15.6

Management believes that providing this additional information enables the reader to better understand the actual operating changes which are impacting the results of operations.

5.6.3 OVERVIEW OF 2004 RESULTS OF OPERATIONS

For the 2003-2005 period we established certain key targets:

- Strengthen our core Italian domestic activities.
- Exploit growth opportunities.
- Improve cost efficiency.

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In 2004 we largely met these targets on the basis of some of key measures we use in monitoring our performance.

With respect to the strengthening of our core Italian domestic activities such key targets were evidenced by:

- During 2004 Telecom Italia's traffic packages and retention strategies resulted in limited revenues losses while its market share on traffic volumes remained stable: Telecom Italia's market share on traffic volumes at December 31, 2004 was 73.1% compared with 73.2% at December 31, 2003. The Wireline Business Unit has implemented various strategies to limit the impact of increasing competition, with such strategies designed to retain customers and minimize the impact of tariff reductions.
- TIM traffic volumes increased by 7.3% in terms of minutes and mobile traffic revenues increased by 1.3% in 2004 compared to 2003 (7,193 million in 2004 against 7,099 million in 2003). The growth in revenue was due to the net increase in lines (up 0.7% compared to 2003) and was mainly attributable to the higher impact of VAS revenues. The average monthly revenue per mobile line (ARPU) (which includes traffic and VAS revenues) increased from approximately 29.1 in 2003 to 30.0 in 2004 (including service revenues from non TIM clients).

In both our core domestic and international markets our strategy confirms the focus of investment on exploiting growth opportunities. In the domestic market our focus has been on value added services and internationally on markets which we consider to have the most potential for growth mobile telecommunications in selected markets, particularly in Latin America, and broadband in selective European markets.

Innovative offer:

- the Wireline Business Unit is focused on converting its customers from traditional to innovative technologies to enlarge IP services and applications. The Wireline Business Unit 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 4,010,000 broadband points of access sold to the retail and the wholesale market at the end of 2004 (2,040,000 at December 31, 2003).
- TIM revenues from Value Added Services (VAS) (1,256 million in 2004) increased by 22.2% compared to 2003. Due to the continuing introduction of new services and the particular success of SMS services, the VAS business grew significantly with revenues from value added services representing 13.4% of service revenues and 12.6% of total revenues in 2004, compared to 11.4% and 10.9%, respectively in 2003.

International markets:

- during 2004 Telecom Italia enlarged the activities of the International Broadband project in Europe. The Wireline Business Unit intends to offer access to innovative broadband services in the main European countries, leveraging on

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its know-how and technological assets, beginning with France and Germany. As of December 31, 2004, Wireline had approximately 420,000 contracts for broadband access outside of Italy (160,000 as of December 31, 2003).

- TIM continued to consolidate its role during 2004. TIM International's presence is now primarily concentrated in Latin America and in the Mediterranean Basin. In December 2004, in addition to customers in Italy, TIM had more than 27.5 million total managed lines in its subsidiaries abroad (including minorities) after giving effect to the proposed sales of TIM Hellas and Digitel.

As discussed under Item 4. Information on the Telecom Italia Group 4.1 Business 4.1.8 Updated Targets and Strategy, we have established certain targets for the 2005-2007 period including compound annual revenue growth over the period of 4-6% and compound annual growth in operating income of 7-9% in each case assuming no changes in the scope of consolidation and exchange rate impacts. Our ability to achieve these targets will be dependent on maintaining our existing competitive position and successfully growing our revenues with value added services and in our targeted international markets. See Item 3. Key Information 3.1 Risk Factors. To achieve these goals our capital expenditures will be focused on investments in innovative, value added services and our targeted international investments. See Item 5 5.7 Liquidity and Capital Resources 5.7.3 Capital

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Expenditures . We anticipate that our revenue mix will, as a result, continue to change over time, as the continuing competitive pressures in our core voice markets persist (wireline and mobile).

The following table sets forth our Italian GAAP statement of operations for the years ended December 31, 2002, 2003 and 2004.

	<u>2002</u>	<u>2003</u>	<u>2004</u>
	(millions of Euro)		
Operating revenues	31,408	30,850	31,237
Other income	504	345	315
Total revenues	31,912	31,195	31,552
Cost of materials	2,315	2,081	2,414
Salaries and social security contributions	4,737	4,303	4,045
Depreciation and amortization	7,227	6,779	6,646
Other external charges	12,188	11,934	12,014
Changes in inventories	62	114	(25)
Capitalized internal construction costs	(675)	(805)	(742)
Total operating expenses	25,854	24,406	24,352
Operating income	6,058	6,789	7,200
Financial income	1,569	992	1,381
Financial expense	(4,647)	(3,256)	(3,215)
<i>Of which write-downs and equity in affiliated and other companies, net</i>	<i>(487)</i>	<i>(91)</i>	<i>(30)</i>
Other income and (expense), net	(5,496)	(1,083)	(410)
Income (loss) before income taxes and minority interests	(2,516)	3,442	4,956
Income taxes	2,210	(1,014)	(3,054)
Net income (loss) before minority interests	(306)	2,428	1,902
Minority interests	(467)	(1,236)	(1,121)
Net income (loss)	(773)	1,192	781

5.6.4 BUSINESS UNIT FINANCIAL DATA

We operate predominantly in Italy and our core business is focused on domestic and international telecommunications services.

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The table below sets forth the gross operating revenues, operating income and certain other data for our Business Units/Corporate Functions, for the last three years:

		Wireline (2)	Mobile (3)	South America (4)	Internet and Media (5)	IT Market (2)(6)	IT Group (2)	Olivetti Tecnost (7)	Sub-total	Other activities and eliminations (2)(4)(8)	Consolidated Total
(millions of Euro, except number of employees)											
Gross operating revenues	2004										
	2003(1)	17,571	12,900	1,076	597	729	965	601	34,439	(3,202)	31,237
		17,216	11,782	1,111	1,297	891	1,100	655	34,052	(3,202)	30,850
	2002(1)	17,047	10,867	1,405	1,991	1,039	996	914	34,259	(2,851)	31,408
Operating income	2004										
	2003(1)	5,199	4,073	121	(89)	36	(67)	21	9,294	(2,094)	7,200
		4,969	3,786	145	63	58	(36)	2	8,987	(2,198)	6,789
	2002(1)	4,677	3,358	154	232	64	(40)	4	8,449	(2,391)	6,058
Capital expenditures	2004										
	2003(1)	2,201	2,490	157	62	25	180	15	5,130	205	5,335
		2,302	1,957	129	102	30	174	20	4,714	180	4,894
	2002(1)	2,475	1,715	214	81	39	149	35	4,708	193	4,901
Number of employees at the year end	2004										
	2003(1)	50,383	20,361	5,080	1,805	4,131	3,160	2,108	87,028	4,337	91,365
		50,766	18,888	4,953	2,029	4,827	4,107	2,395	87,965	5,222	93,187
	2002(1)	53,935	18,702	5,403	7,715	5,506	5,039	4,527	100,827	5,793	106,620

(1) The data relating to 2003 and 2002 have been reclassified and presented consistent with the 2004 presentation.

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- (2) Starting from January 1, 2003, the NETikos group, the Webegg group, TILab, Loquendo and Eustema are no longer consolidated by the IT Group Operating Activity. BBNed is no longer included in Other Activities. TILab moved to Other activities and Loquendo and BBNed became part of Wireline, whereas the other companies moved to the IT Market Business Unit. The effects of such reclassifications were not material.
- (3) On April 3, 2005 an agreement was reached to dispose of the equity interest held in TIM Hellas. The closing of the transaction, subject to, among other things, the approval by the competent authorities, is expected to occur by the end of July 2005. On November 5, 2004, a memorandum of understanding for the sale of Corporacion Digitel was reached by TIM with CANTV (Compania Anonima Nacional Teléfonos de Venezuela). On May 5, 2005, regulatory authorities in Venezuela decided not to grant authorization for the proposed sale. The decision is subject to administrative and judicial review and TIM International intends to pursue appropriate remedies.
- (4) The data refer to Entel Chile Group and Entel Bolivia Group. 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 our chosen strategy to consolidate and develop our international presence in the Latin America geographical area. The Wireline and Mobile business units with their present corporate organizational structure are nevertheless responsible for the results of the subsidiaries in Latin America under their control. As a result of this reorganization and with effect on January 1, 2004, the company Telecom Italia Latam S.A. and the business segment South America of Telecom Italia are included in Other activities.

On January 24, 2005 Telecom Italia International N.V. executed an agreement for the disposal of its 54.76% equity stake in Entel Chile S.A. to Almendral S.A., a holding company listed on the Santiago Stock Exchange in Chile; the price for the transaction is U.S.\$934 million, which corresponds to a value of U.S.\$1,706 million for 100% of Entel S.A.. The transaction closed on March 29, 2005.

- (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 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.

On April 4, 2005 the Boards of Directors of Telecom Italia and Telecom Italia Media authorized the restructuring of the Telecom Italia Group's Internet business whereby Telecom Italia will acquire all of Telecom Italia Media's Internet activities. The proceeds of such sale will be used by Telecom Italia Media to, among other things, expand its business.

- (6) On April 26, 2005 Telecom Italia signed a sale and purchase agreement with Almaviva Technologies, the COS Group holding company, for the sale of its entire stake (79.5%) in Finsiel S.p.A.. The transaction is based upon a Finsiel enterprise value of approximately 164 million.
- (7) On April 5, 2005, Olivetti Tecnost S.p.A. was renamed Olivetti S.p.A..
- (8) The data include the operations of the International Affairs Corporate Function, 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, the staff functions, the company Telecom Italia Latam S.A. and the business segment South America of Telecom Italia.

5.6.5 YEAR ENDED DECEMBER 31, 2004 COMPARED WITH YEAR ENDED DECEMBER 31, 2003

V CONSOLIDATED OPERATING REVENUES

Our consolidated operating revenues increased by 1.3% in 2004 compared to 2003 from 30,850 million in 2003 to 31,237 million in 2004. Organic growth was 4.9% (1,457 million), excluding the negative effect of changes in exchange rates (175 million, of which 150 million was attributable to the Latin American telecommunication companies of the Mobile Business Unit) and the effect of the change in the scope of consolidation (895 million, of which 703 million related to the sale in August 2003 of New SEAT).

Organic growth in operating revenues was largely due to the following:

- a significant increase in the revenues of the Mobile Business Unit (1,268 million), which were driven by the positive trend in the domestic market (474 million) as well as the positive contribution of international activities;
- an increase in the revenues of the Wireline Business Unit (303 million), largely attributable to the success of efforts to develop the Broadband market and innovative services in particular Web services together with efforts to defend our position in the core wireline market and enhance the range of wholesale services;
- an increase in the revenues of the Internet and Media Business Unit (76 million) and Olivetti Tecnost Business Unit (15 million).

These increases were offset in part by:

- a decrease in the revenues of the IT Market Business Unit (99 million) as a result of recording non recurring sales in 2003 on an important contract relating to the Telcal project and of the wireline/integrated companies in South America (41 million) mainly attributable to the Entel Chile Group.

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The table below sets forth, for the periods indicated, gross operating revenues and consolidated operating revenues by Business Unit and Corporate Function and the percentage contribution of such Business Unit and Corporate Function to our consolidated operating revenues.

	Year ended December 31,					
	2003(1)			2004		
	Gross Operating Revenues(2)	Consolidated Operating Revenues(3)	% of Consolidated Operating Revenues	Gross Operating Revenues(2)	Consolidated Operating Revenues(3)	% of Consolidated Operating Revenues
	(millions of Euro, except percentages)					
Wireline(4)	17,216	15,364	49.8%	17,571	15,761	50.5%
Mobile(5)	11,782	11,562	37.5%	12,900	12,634	40.4%
South America(6)	1,111	1,102	3.6%	1,076	1,068	3.4%
Internet and Media(7)	1,297	1,122	3.6%	597	404	1.3%
IT Market(4)(8)	891	804	2.6%	729	682	2.2%
IT Group(4)	1,100	41	0.1%	965	22	0.1%
Olivetti Tecnost(9)	655	637	2.1%	601	544	1.7%
Other activities (4)(6)(10)	1,141	218	0.7%	1,181	122	0.4%
Total operating revenues	35,193	30,850	100.0%	35,620	31,237	100.0%

(1) The data relating to 2003 has been reclassified and presented consistent with the 2004 presentation.

(2) Gross operating revenues are total revenues of the various business units of the Telecom Italia Group before elimination of intercompany sales (but after elimination of sales between companies within the same major business area).

(3) Consolidated operating revenues are revenues recorded by each business area on a consolidated basis after elimination of intercompany sales.

(4) Starting from January 1, 2003, the NETikos group, the Webegg group, TILab, Loquendo and Eustema are no longer consolidated by the IT Group Function. BBNed is no longer included in Other Activities. TILab moved to Other activities and Loquendo and BBNed became part of Wireline, whereas the other companies moved to the IT Market Business Unit. The effects of such reclassifications were not material.

(5) On April 3, 2005 an agreement was reached to dispose of the equity interest held in TIM Hellas. The closing of the transaction, subject to, among other things, the approval by the competent authorities, is expected to occur by the end of July 2005. On November 5, 2004, a memorandum of understanding for the sale of Corporacion Digitel was reached by TIM with CANTV (Compania Anonima Nacional Telefonos de Venezuela). On May 5, 2005, regulatory authorities in Venezuela decided not to grant authorization for the proposed sale. The decision is subject to administrative and judicial review and TIM International intends to pursue appropriate remedies.

(6) The data refer to Entel Chile Group and Entel Bolivia Group. 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

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Latam S.A. has now taken over the new role of the delocalized Corporate function in Latin America, consistent with our chosen strategy to consolidate and develop our international presence in the Latin America geographical area. The Wireline and Mobile business units with their present corporate organizational structure are nevertheless responsible for the results of the subsidiaries in Latin America under their control. As a result of this reorganization and with effect on January 1, 2004, the company Telecom Italia Latam S.A. and the business segment South America of Telecom Italia are included in Other activities.

On January 24, 2005 Telecom Italia International N.V. executed an agreement for the disposal of its 54.76% equity stake in Entel Chile S.A. to Almendral S.A., a holding company listed on the Santiago Stock Exchange in Chile; the price for the transaction is U.S.\$934 million, which corresponds to a value of U.S.\$1,706 million for 100% of Entel S.A.. The transaction closed on March 29, 2005.

- (7) New SEAT, the beneficiary company of the spin-off from Seat Pagine Gialle which took place on August 1, 2003, was sold on August 8, 2003. As a result, the 2003 figures include the results of operations for the first seven months of New SEAT Group, as well as the 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.

On April 4, 2005 the Boards of Directors of Telecom Italia and Telecom Italia Media authorized the restructuring of the Telecom Italia Group's Internet business whereby Telecom Italia will acquire all of Telecom Italia Media's Internet activities. The proceeds of such sale will be used by Telecom Italia Media to, among other things, expand its business.

- (8) On April 26, 2005 Telecom Italia signed a sale and purchase agreement with Almviva Technologies, the COS Group holding company, for the sale of its entire stake (79.5%) in Finsiel S.p.A.. The transaction is based upon a Finsiel enterprise value of approximately 164 million.

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

- (10) The data include the operations of the International Affairs Corporate Function, TILab, as well as the financial companies, the centralized group services, the staff functions, the company Telecom Italia Latam S.A. and the business segment South America of Telecom Italia.

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The table below sets forth, for the periods indicated, consolidated operating revenues by geographic area and the percentage of total consolidated operating revenues:

Geographic Area	Year ended December 31,			
	2003		2004	
	(millions of Euro, except percentages)			
Italy	24,811	80.5%	24,608	78.8%
Rest of Europe	2,478	8.0%	2,588	8.3%
North America	589	1.9%	537	1.7%
Central and South America	2,566	8.3%	3,118	10.0%
Australia, Africa and Asia	406	1.3%	386	1.2%
Total consolidated operating revenues	30,850	100.0%	31,237	100.0%

V OPERATING EXPENSES

The table below sets forth, for the periods indicated, total consolidated operating expenses by major components and expressed as a percentage of total consolidated operating revenues.

	Year ended December 31,			
	2003		2004	
	(millions of Euro, except percentages)			
Cost of materials	2,081	6.7%	2,414	7.7%
Other external charges	11,934	38.7%	12,014	38.5%
Personnel costs (salaries and social security contributions)	4,303	13.9%	4,045	12.9%
Changes in inventories	114	0.4%	(25)	(0.1)%
Capitalized internal construction costs	(805)	(2.6)%	(742)	(2.4)%
Depreciation and amortization	6,779	22.0%	6,646	21.3%
Total operating expenses	24,406	79.1%	24,352	77.9%

Our operating expenses decreased by 54 million in 2004 compared to 2003. The decrease was mainly attributable to lower personnel costs, and lower depreciation of tangible assets and amortization of intangible assets (including goodwill) partially offset by the increase in the cost of materials.

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As a percentage of our operating revenues, operating expenses represented 79.1% and 77.9% in 2003 and 2004, respectively.

V COST OF MATERIALS

Cost of materials increased by 333 million or 16.0% in 2004 compared to 2003, as a consequence of Christmas advertising campaigns for Mobile and Wireline Business Units and the acquisition of increased numbers of the Aladino cordless phone and videophone to meet customer demand.

V OTHER EXTERNAL CHARGES

The table below sets forth, for the periods indicated, consolidated other external charges broken down by major components.

	Year ended December 31,	
	2003	2004
	(millions of Euro)	
Costs of external services rendered	9,684	9,857
Rents and lease payments	1,156	1,087
Provision for bad debts	471	275
Provision for risks	70	74
Write-downs of tangible and intangible fixed assets	6	5
Regulatory license fees	62	103
Other provisions and operating charges	485	613
	11,934	12,014
Total other external charges	11,934	12,014

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Other external charges increased by 80 million or 0.7% in 2004 compared to 2003. These charges include costs of external services rendered, write-downs of tangible and intangible fixed assets, provision for bad debts, rents and lease payments, telecommunications license fees and other provisions and operating charges.

- Costs of external services rendered increased by 173 million or 1.8% in 2004 compared to 2003. The increase was principally due to higher costs to operate and develop mobile telecommunications (including the start-up of GSM services in Brazil) and Wireline telecommunications, partly offset by the change in the scope of consolidation due to the sale of New Seat.
- Provision for bad debts declined by 196 million or 41.6% in 2004 compared to 2003. The provision for bad debts is made to write-down receivables to their expected present realizable value.
- Regulatory license fees (which include fees paid for TLC licenses) increased by 41 million or 66.1% in 2004 compared to 2003.
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