

TELECOM ITALIA S P A  
Form 20-F  
June 21, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 20-F**

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

**x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the fiscal year ended: December 31, 2006**

**OR**

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

**OR**

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

**Commission file number: 1-13882**

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

**(Exact name of Registrant as specified in its charter)**

**Italy**

**(Jurisdiction of incorporation or organization)**

**Piazza degli Affari 2, 20123 Milan, Italy**

**(Address of principal executive offices)**

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

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

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

**None**

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(Title of Class)

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

**None**

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(Title of Class)

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

Ordinary Shares 13,254,906,691

Savings Shares 6,026,120,661

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

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

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

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

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

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

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**Introduction**

**INTRODUCTION**

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

Unless otherwise indicated, the financial information contained in this Annual Report has been prepared in conformity with International Financial Reporting Standards as adopted by the European Commission for use in the European Union ( **IFRS** ), which, as described in Note 46 Reconciliation of IFRS as Adopted by the EU to U.S. GAAP of the Notes to the Consolidated Financial Statements, differ in certain material respects from generally accepted accounting principles in the United States ( **U.S. GAAP** ). Unless otherwise indicated, any reference in this Annual Report to Consolidated Financial Statements is to the Consolidated Financial Statements of the Telecom Italia Group (including the notes thereto) included elsewhere herein.

Telecom Italia adopted IFRS for the first time in its annual Consolidated Financial Statements for the year ended December 31, 2005, which included comparative financial statements for the year ended December 31, 2004. See Item 5. Operating and Financial Review and Prospects 5.4 Adoption of International Financial Reporting 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. Forward-looking statements are statements that are not historical facts and can be identified by the use of forward-looking terminology such as believes, may, is expected to, will, will continue, seeks or anticipates or similar expressions or the negative thereof or other comparable terminology, or by the forward-looking nature of discussions of strategy, plans or intentions.

The forward-looking statements in this Annual Report include, but are not limited to, the discussion of the changing dynamics of the telecommunications marketplace, including the continuing developments in competition in all aspects of our businesses from new competitors and from new and enhanced technologies, our outlook for growth in the telecommunications industry both within and outside of Italy, including our outlook regarding developments in the telecommunications industry, and certain trends we have identified particularly in our core Italian market, including 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 4.1.7 Updated Strategy , (iii) Item 4. Information on the Telecom Italia Group 4.3 Regulation , (iv) Item 5. Operating and Financial Review and Prospects , (v) Item 8. Financial Information 8.2 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 is based on certain key assumptions which we believe to be reasonable but forward-looking information by its nature involves risks and uncertainties, which are outside our control, that could significantly affect expected results.

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

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

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**Introduction**

- our ability to achieve the planned synergies expected to be generated by the convergence between fixed telephony, mobile, broadband internet and media content including in expenses, capital expenditures and capacity to launch new convergent services;
- the success of our customer loyalty and retention programs and the impact of such programs on our revenues;
- our ability to successfully implement our Internet and broadband strategy both in Italy and abroad;
- our ability to successfully achieve our debt reduction targets;
- the impact of regulatory decisions and changes in the regulatory environment in Italy and other countries in which we operate;
- the impact of economic development generally on our international business and on our foreign investments and capital expenditures;
- the continuing impact of rapid or disruptive changes in technologies;
- the impact of political and economic developments in Italy and other countries in which we operate;
- the impact of fluctuations in currency exchange and interest rates;
- our ability to successfully implement our strategy over the 2007-2009 period;
- our ability to achieve the expected return on the investments and capital expenditures we have made and continue to make in Brazil on mobile and in Europe on broadband;
- our ability to successfully strengthen our business and exploit new adjacent markets, such as Pay-TV and IT services;
- the amount and timing of any future impairment charges for our licenses, goodwill or other assets;
- the outcome of litigation, disputes and investigations in which we are involved or may become involved; and
- decreased mobile communications usage arising from actual or perceived health risks or other problems relating to mobile handsets or transmission masts.



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

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**Key Definitions**

**KEY DEFINITIONS**

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

|  |   |
|--|---|
| <b>Domestic Mobile</b>                                 | means the unit which operates our Italian mobile business.  |
| <b>EU</b>  | means the European Union.   |
| <b>IFRS</b>  | means International Financial Reporting Standards, as adopted by the European Commission for use in the European Union.   |
| <b>Merger</b>  | means the merger of Old Telecom Italia into Olivetti, which became effective on August 4, 2003.   |
| <b>Old Telecom Italia and Old Telecom Italia Group</b> | means Telecom Italia and its consolidated subsidiaries as they existed immediately prior to the effective date of the Merger.   |
| <b>Olivetti</b>  | unless otherwise indicated, means Olivetti S.p.A., the holding company and controlling shareholder of Old Telecom Italia.   |
| <b>Olivetti Group</b>                                  | means Olivetti and its consolidated subsidiaries, including Old Telecom Italia.   |
| <b>Ordinary Shares</b>                                 | means the Ordinary Shares, 0.55 par value each, of Telecom Italia.  |
| <b>Savings Shares</b>                                  | means the Savings Shares, 0.55 par value each, of Telecom Italia.   |
| <b>Telecom Italia</b>                                  | means the entity which resulted from the Merger.  |
| <b>Telecom Italia Group and Group</b>                  | means the Company and its consolidated subsidiaries.  |
| <b>Telecom Italia Media</b>                            | Telecom Italia Media is the Telecom Italia Group's subsidiary operating in the Media business.  |
| <b>TIM</b>   | means Telecom Italia Mobile S.p.A., the Telecom Italia Group's subsidiary which operated in the mobile telecommunications business, and merged with and into Telecom Italia, with Telecom |

Italia as the surviving company, effective as from June 30, 2005.

**Tim Italia**

means the company deriving from the spin-off of TIM's domestic mobile assets, effective as from March 1, 2005. After the merger of TIM with and into Telecom Italia, Tim Italia became a wholly-owned subsidiary of Telecom Italia. Subsequently Tim Italia merged with and into Telecom Italia, with Telecom Italia as the surviving company, effective as from March 1, 2006.

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Item 1. Identity of Directors, Senior Management and Advisers

**Risk Factors**

Item 2. Offer Statistics and Expected Timetable

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**

**RISKS RELATED TO TELECOM ITALIA**

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

In 2006, the Group continued its organizational restructuring aimed at capturing opportunities and benefits offered by the convergence process in the telecommunications (fixed and mobile) sector and in adjacent markets (Pay-TV and IT services). The original organizational restructuring resulted in the implementation of a new working model based on:

- business functions dedicated to the development of specific market/segment targets (domestic and international fixed/broadband, domestic and international mobile, Top clients and ICT);
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across-the-board monitoring to improve cost efficiency, process effectiveness and service quality (Technology for the development and operation of infrastructures and service platforms, Field Services for the development and improvement of customer assistance); and

- rationalization of Group Functions providing guidance and control.

The new model is intended to provide a more flexible operating structure to address the technological changes and national and international competition which is facilitating the convergence between fixed telephony, mobile, broadband internet and media content.

On March 9, 2007, we presented to the investor community our strategic targets for the period 2007-2009; the Group's strategy is to:

- defend the Group's leadership position in its Italian domestic fixed-line and mobile markets, leveraging the increasing penetration of broadband, fixed-line/mobile convergence, transparent and flexible customer offerings, ongoing innovation and development of value added services;
- expand into adjacent market sectors, mainly through the rollout of content offerings on innovative platforms (IPTV and Mobile TV), while broadening and strengthening ICT offerings to business customers;
- increase focus on the customer, through higher investment in Customer Care and quality of service;
- continue broadband network development and launch of the Next Generation Network 2 project, building an ultra-broadband network in line with market demand, and consistent with the evolution of the regulatory framework; and
- develop the Group's international footprint, maintaining its presence in South America (mobile telephony in Brazil, and the project aimed at acquiring control of Telecom Argentina in 2009) while consolidating European projects in Germany, France and The Netherlands.

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

- declining prices for some of our services, increasing competition and regulatory developments which create pressure on margins and enhance competition;

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**Item 3. Key Information**

**Risk Factors**

- our ability to manage costs;
- our ability to attract and retain highly-skilled and qualified personnel;
- the entry of new competitors in the liberalized Italian telecommunications market and the other principal markets in which we operate, which may result in our losing market share in Italy and internationally;
- our ability to strengthen our competitive position through our focus on new adjacent markets (Pay-TV and IT services) and international markets (Mobile in Brazil and broadband in Europe) based on our specialized skills and technical resources;
- our ability to successfully develop and introduce new technologies to meet market requirements, to manage innovation, to provide value-added services and to increase the usage of our fixed and mobile networks;
- our ability to achieve the synergies anticipated from the convergence of fixed communications, mobile communications and Internet;
- the effect of adverse economic trends on our principal markets;
- the success of new disruptive technologies that could cannibalize fixed and mobile revenues; and
- the effect of foreign exchange fluctuations on our results of operations.

*There can be no assurance that our objectives will be effectively implemented in the planned time-frames.*

***As a result of the Merger, the cash tender offer for TIM shares and the merger of TIM into Telecom Italia, in 2004 and 2005, we remain highly leveraged.***

Our gross financial debt was 46,456 million at December 31, 2006 compared with 52,101 million at December 31, 2005, and our total net financial debt was 37,301 million as of December 31, 2006 compared with 39,858 million at December 31, 2005. See Item 5. Operating and Financial Review and Prospects 5.5 Results of Operations for the Three Years Ended December 31, 2006 5.5.2. Non-GAAP Financial Measures , which reconciles our net financial debt to the gross financial debt.

Our goal is to reduce our net financial debt during 2007 through cash flow generation and the disposal of non-strategic equity holdings and assets. Factors beyond our control, including but not limited to, deterioration in general economic conditions, could significantly affect our ability to generate cash to reduce debt or to refinance existing debt through further borrowing. In addition, our goal to reduce debt may diminish our ability to face competitive threats, take advantage of attractive acquisition opportunities or

pursue a strategy requiring substantial cash consumption.

Due to the competitive environment and the economic conditions in which the Telecom Italia Group operates, there could be deterioration in the statement of income and balance sheet ratios. These same ratios are used by the rating agencies, such as Moody's and Standard & Poor's, in rating the Group's ability to repay its debt.

See Item 5. Operating and Financial Review and Prospects 5.6. Liquidity and Capital Resources 5.6.2 Capital Resources .

Although ratings downgrades do not have an immediate impact on outstanding debt, except for outstanding debt instruments that specifically contemplate ratings in order to determine payouts, or on its relative cost to us, downgrades could lead to a greater risk with respect to refinancing existing debt or higher refinancing costs.

The management and further development of our business require us to make further significant investments. We may therefore incur additional debt in order to finance such investment. Our future results of operations may be influenced by our ability to enter into such transactions, which in turn will be determined by market conditions and factors that are outside our control. In addition, if such transactions increased our leverage it could adversely affect our credit ratings.

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**Item 3. Key Information**

**Risk Factors**

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

Telecom Italia intends to continue to build its international presence in the strategic broadband and mobile areas, maintaining the geographic focus in Europe and South America (Brazil and Argentina). Pursuant to our 2007-2009 plan we will continue to target our international investments in South America, particularly mobile telecommunications in Brazil and our existing investment in Telecom Argentina and European broadband, such as France, Germany and The Netherlands. These investments will continue to require significant capital expenditures and there can be no assurance that we will be able to achieve a satisfactory return on such international investments. In addition, our existing investments pose certain risks, such as:

- in Germany, the main risk is represented by the integration process with America Online, which was acquired in February, 2007;
- in France, the efforts are directed to the turnaround of operations with a strong focus on the business becoming profitable;
- in Brazil, is confirmed potential for growth in that market where Tim Brasil is pushing to further narrow the gap with the leading operator;
- in Argentina, in the medium term, it is expected that control of Telecom Argentina will be acquired through the exercise of call options.

Telecom Italia could fail to obtain an adequate return on its foreign investments owing, among other things, to growing competition and technological discontinuity in countries in which the Group has an international business presence.

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

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

***Our business depends on the upgrading of our existing networks.***

We must continue to upgrade our existing wireless and fixed-line networks in a timely and satisfactory manner in order to retain and expand our customer base in each of our markets, to enhance our financial performance and to satisfy regulatory requirements.



Among other things, we could be required to:

- upgrade the functionality of our networks to permit increased customization of services;
- increase coverage in some of our markets;
- expand and maintain customer service, network management and administrative systems; and
- upgrade older systems and networks to adapt them to new technologies.

Many of these tasks are not entirely under our control and may be affected by applicable regulation. If we fail to execute them successfully, our services and products may be less attractive to new customers and we may lose existing customers to our competitors, which would adversely affect our business, financial condition and results of operations.

***We are continuously involved in disputes and litigation with regulators, competitors and other parties. The ultimate outcome of such legal proceedings is generally uncertain. When finally concluded, they may have a material adverse effect on our results of operations and financial condition.***

We are subject to numerous risks relating to legal and regulatory proceedings, in which we are currently a party or which could develop in the future. Litigation and regulatory proceedings are inherently unpredictable. Legal or

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**Item 3. Key Information**

**Risk Factors**

regulatory proceedings in which we are or come to be involved (or settlements thereof) may have a material adverse effect on our results of operations or financial condition.

Furthermore, our involvement in litigation and regulatory proceedings may adversely affect our reputation.

For information concerning some of the litigation in which we are involved, see Item 8. Financial Information 8.2. Legal Proceedings . For information concerning our regulatory framework, see Item 4. Information on the Telecom Italia Group 4.3. Regulation.

***Risks associated with Telecom Italia s ownership chain.***

Telecom Italia elected a new Board of Directors on April 16, 2007. The appointment of the new Board of Directors will expire upon the approval of the financial statements for the year 2007 when a new Board of Directors will be elected. Because of the so-called *voto di lista* system or *slate voting system* for the election of directors, Olimpia S.p.A., ( **Olimpia** ), our largest shareholder put forward a slate of directors from which 15 out of 19 of Telecom Italia s directors (of whom 9 are considered independent) were elected. Please see Item 4. Information on the Telecom Italia Group 4.1. Business 4.1.1. Background . Since the shareholder meeting of April 16, 2007, the shareholders in Olimpia have agreed to sell their stake in Olimpia to a new vehicle, Telco S.p.A., as described below. Telco S.p.A., on completion of the acquisition of Olimpia will hold approximately 23.6% of our outstanding Ordinary Shares.

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

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

Telecom Italia s financial position is not directly related to Olimpia and as such Telecom Italia does not have any obligations with respect to such debt since they are separate legal entities. Notwithstanding the foregoing, since certain rating agencies might view Telecom Italia s financial position as linked in some way to that of Olimpia, such a view could affect our debt ratings, which may adversely affect Telecom Italia s financial flexibility and its cost of capital. Please see Item 7. Major Shareholders and Related-Party Transactions 7.1 Major Shareholders.

Olimpia's shareholding structure is presently undergoing some major changes, which should result in Telecom Italia's ownership chain being transformed. Please see Item 4. Information on the Telecom Italia Group 4.1 Business 4.1.1 Background. More specifically, a group of Italian investors made up of Assicurazioni Generali S.p.A., Intesa Sanpaolo S.p.A., Mediobanca S.p.A. and Sintonia S.A., together with Telefónica S.A., the Spain based international telecoms operator, entered into an agreement aimed at the acquisition of the entire share capital of Olimpia through a company vehicle named Telco S.p.A. The acquisition is subject to approval by the competent authorities. Presently Telefónica and Telecom Italia are direct competitors in certain areas out of their respective domestic markets; nevertheless, the agreement among the above mentioned parties provides that the Telecom Italia and Telefónica groups will be managed autonomously and independently. For further information on this topic, please see Item 10. Additional Information 10.1 Corporate Governance 10.1.2 General Impact of Shareholders Agreements on the Nomination of Telecom Italia Group's Companies Boards. If, at the time of the appointment of a new Board of Directors of Telecom Italia, Telco S.p.A. will be Telecom Italia's largest shareholder, Telco S.p.A., through the slate voting system, will be able to put forward a slate of directors from which the majority of the members of the Board of Directors is likely to be elected. In addition, the discussion in the preceding three paragraphs will also apply to Telco S.p.A. if they successfully complete the acquisition of Olimpia.

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***The Italian State, through the Treasury, is in a position to exert certain powers with respect to Telecom Italia.***

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

**RISKS RELATED TO THE TELECOMMUNICATIONS INDUSTRY AND FINANCIAL MARKETS**

***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 to a large degree 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. Certain 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.

***Because we operate in heavily regulated business environments, regulatory decisions and changes in the regulatory environment could materially adversely affect our business.***

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

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

Included within this new framework is the obligation on the part of the Italian regulator responsible for the regulation of the telecommunications, radio and television broadcasting sector (the National Regulatory Authority or **NRA**) to identify operators with significant market power based on a market analysis in eighteen separate retail and wholesale markets in which it is considered

necessary to intervene to protect free competition. The framework established criteria and procedures for identifying remedies applicable to operators with significant market power . During 2006, the NRA concluded all of its preliminary inquiries regarding the analysis of the markets and introduced measures as a result of this analysis. For further details please see Item 4. Information on the Telecom Italia Group 4.3. Regulation .

In Italy, we are subject to universal service obligations, which require us to provide fixed-line public voice telecommunications services in non-profitable areas. We are the only operator in Italy which has this obligation. In addition, the NRA has identified us as an operator having significant market power in most relevant markets. As a result, we are, and, if we continue to be identified as having significant market power in most relevant markets, will be, subject to a number of regulatory constraints, including:

- a requirement to conduct our business in a transparent and non-discriminatory fashion;
- a requirement to have our prices for fixed voice telephony services and Reference Interconnection Offer, the tariff charged to other operators to utilize our network, subject respectively to a price cap and a network cap mechanism. This cap mechanism places certain limits on our ability to change our prices for certain services; and

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- a requirement to provide interconnection services, leased lines and access to the local loop to other operators at cost-orientated prices. These services include allowing other operators to connect to our network and transport traffic through the network as well as offering certain services related to our local access network, or local loop, on an unbundled basis to these other operators to enable these operators to directly access customers connected to the network by leasing the necessary components from us.

These constraints have had an adverse impact on our fixed line network pricing and service offerings and future regulatory decisions are expected to continue to have an adverse impact on our market shares and margins.

In addition, the NRA intends to address other markets that are currently not subject to regulation (for example virtual private networks and VoIP). VoIP is an emerging market for nomadic voice telephony services that are based on the Internet and are not dependent on specific customer telephone lines. Nevertheless, the NRA has included VoIP in the same market as conventional voice telephony services. Therefore these markets may be treated in the same way as the market for conventional telephone services for the purpose of regulation and may also be subject to price regulation.

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

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

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

***Strong competition in Italy may further reduce our core market share for telecommunication services and may cause further reductions in prices and margins thereby having an adverse effect on our results of operations.***

Strong competition exists in all of the principal telecommunications business areas in Italy in which we operate, including, most significantly, the fixed-line and mobile voice telecommunications businesses. The use of the single European currency and the liberalizations of the Italian telecommunication market (since January 1998) have intensified competition by facilitating international operators entry into the Italian market and direct competition with our fixed-line and mobile telephony businesses, particularly in the local and long-distance markets.

Competition continued to intensify during 2006. As of December 31, 2006, there were a number of significant competitors offering fixed-line services and three other operators (in addition to Telecom Italia) offering mobile services in the Italian domestic market. This competition may further increase due to the consolidation and globalizations of the telecommunications industry in Europe, including Italy, and elsewhere.

We anticipate that in the short to medium-term there may be a stronger entry of peer-level international competitors into markets with existing operators, including Italy, increasing the direct competition we face in our Italian domestic fixed-line and mobile telephony businesses and in the local and long-distance markets.

Competition in our principal lines of business could lead to:

- further price and margin erosion for our products and services;
- a loss of market share in core markets;
- loss of existing or prospective customers and greater difficulty in retaining existing customers;
- obsolescence of existing technologies and more rapid deployment of new technologies;

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- an increase in costs related to investments in new technologies that are necessary to retain customers and market share; and
- difficulties reducing debt and strategic and technological investments if we cannot generate sufficient profits and cash flow.

Although we have taken a number of steps to realize additional efficiencies and introduce innovative and value added services over our networks, and although our plans take into account that we face significant competition from a number of operators in all the markets in which we operate, if any or all of the events described in the preceding paragraph should occur, the impact of such factors could materially adversely affect our results of operations.

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

In order to sustain growth in revenues despite increased competition and lower prices, particularly in our core Italian domestic market, our strategy has been to introduce new services in our fixed-line and wireless businesses to increase traffic on our networks and find alternative revenue sources, in addition to carrying voice traffic on our networks. In the past three years the Group's strategy to increase revenues has been to focus on penetration of the broadband retail market with various broadband offers as well as to increase value added services in the mobile businesses. These markets have been growing the past three years in line with increased use of the Internet and the enhanced services offered by mobile operators. However, if these markets do not continue to expand, our revenues may not grow, or even decrease, as revenues from other parts of our business, particularly our traditional fixed-line business, decline due to competition or other price pressures.

In addition, 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.

***Continuing rapid changes in technologies could increase competition, reduce usage of traditional services or require us to make substantial additional investments.***

Many of the services we offer are technology-intensive and the development or acceptance of new technologies may render such services non-competitive, replace such services or reduce prices for such services. In addition, as convergence of services accelerate, we make and will have to make substantial additional investments in new technologies to remain competitive. The new technologies we choose may not prove to be commercially successful. In addition, we may not receive the necessary licenses to provide services based on new technologies in Italy or abroad. Furthermore, our most significant competitors in the future may be new entrants to our markets who do not have to maintain an installed base of older equipment.

As a result, we could lose customers, fail to attract new customers or incur substantial costs in order to maintain our customer base or to maintain revenues from such customer base.



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

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

We acquired a third generation mobile telephone, or UMTS, license to provide UMTS services in Italy for 2,417 million and have made significant investments, in accordance with the terms and conditions of our licenses, to create the infrastructure to offer UMTS services. We commenced offering UMTS services in Italy in the second half of 2004 and have made in 2005 and 2006, and will have to continue to make in the future, significant investments in promotional activities relating to our UMTS services. Given the substantial costs of

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upgrading our existing networks to support UMTS, the ongoing costs to market and support these new services, and the significant competition among operators who offer these new services, including one operator only offering 3G services, we may not be able to recoup our investments, as planned if at all.

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

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

In addition, as our core domestic Italian market has become increasingly saturated, the focus of competition has shifted to customer retention from customer acquisition, and increasing the value of existing customers. Such focus could result in increased expenses to retain customer loyalty or if we are unable to satisfactorily offer better value to our customers our market share and revenues could decline.

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.

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

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

- Internet usage in Italy grows more slowly than anticipated, for reasons such as changes in Internet users' preferences;

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

Outside of Italy our ability to implement this strategy will depend on whether we are able to acquire assets or networks or utilize networks of incumbent operators that will allow us to offer such services. Any of the above factors may adversely affect the successful implementation of our strategy, our business and results of operations.

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

The effects of and any damage caused by exposure to an electromagnetic field were and are the subject of careful evaluations by the international scientific community, but until now there is no scientific evidence of harmful effects on health. 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

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

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

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

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

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

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

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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 **U.S. dollars**, **dollars**, **U.S.\$** or **\$** are to U.S. dollars, the currency of the United States of America.

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.\$ 1.3197, 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 29, 2006.

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.

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

The following table sets forth for the years 2002 to 2006 and for the beginning of 2007 certain information regarding the Noon Buying Rate for Dollars expressed in U.S.\$ per 1.00.

| <b>Calendar Period</b>            | <b>High</b> | <b>Low</b> | <b>Average(1)</b> | <b>At Period end</b> |
|-----------------------------------|-------------|------------|-------------------|----------------------|
| 2002                              | 1.0485      | 0.8594     | 0.9495            | 1.0485               |
| 2003                              | 1.2597      | 1.0361     | 1.1411            | 1.2597               |
| 2004                              | 1.3625      | 1.1801     | 1.2438            | 1.3538               |
| 2005                              | 1.3476      | 1.1667     | 1.2448            | 1.1842               |
| 2006                              | 1.3327      | 1.1860     | 1.2563            | 1.3197               |
| 2007 (through June 13, 2007)      | 1.3660      | 1.2904     | 1.3287            | 1.3295               |
| <b>Monthly Rates</b>              |             |            |                   |                      |
| December 2006                     | 1.3327      | 1.3073     | 1.3205            | 1.3197               |
| January 2007                      | 1.3286      | 1.2904     | 1.2993            | 1.2998               |
| February 2007                     | 1.3246      | 1.2933     | 1.3080            | 1.3230               |
| March 2007                        | 1.3374      | 1.3094     | 1.3246            | 1.3374               |
| April 2007                        | 1.3660      | 1.3363     | 1.3513            | 1.3660               |
| May 2007                          | 1.3616      | 1.3419     | 1.3518            | 1.3453               |
| June 2007 (through June 13, 2007) | 1.3526      | 1.3295     | 1.3416            | 1.3295               |

(1) Average of the rates for each month in the relevant period except for June, 2007 for which the dates used are through June 13, 2007.

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The Ordinary Shares, par value 0.55 (the **Ordinary Shares**) and Savings Shares, par value 0.55 (the **Savings Shares**) of Telecom Italia trade on *Mercato Telematico Azionario* (**Telematico**), managed by Borsa Italiana S.p.A. (**Borsa Italiana**) in euro. Fluctuations in the exchange rate between the euro and the U.S. dollar will affect the U.S. dollar equivalent of the euro price of the Ordinary Shares and the Savings Shares and the price of the Ordinary Share American Depositary Shares (**Ordinary Share ADSs**) and the Savings Share American Depositary Shares (**Savings Share ADSs**), on the New York Stock Exchange (**NYSE**). Cash dividends are paid in euro (Olivetti paid no dividend in 2002). Exchange rate fluctuations will affect the U.S. dollar amounts received by owners of Ordinary Share ADSs and Savings Share ADSs upon conversion by the Depositary of cash dividends paid in euro on the underlying Ordinary Shares and Savings Shares. See Item 10. Additional Information 10.5 Description of American Depositary Receipts .

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

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**3.3 SELECTED FINANCIAL AND STATISTICAL INFORMATION**

The summary selected financial data set forth below are consolidated financial data of the Telecom Italia Group as of and for each of the years ended December 31, 2006, 2005 and 2004, which have been extracted or derived from the Consolidated Financial Statements of the Telecom Italia Group prepared in accordance with IFRS and which have been audited by the independent auditor Reconta Ernst & Young S.p.A..

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

Until December 31, 2004, Telecom Italia prepared its consolidated financial statements and other interim financial information (including quarterly and semi-annual data) in accordance with Italian GAAP. Pursuant to SEC Release 33-8567, *First-Time Application of International Financial Reporting Standards*, Telecom Italia is only required to include Selected Financial Data extracted or derived from the Consolidated Financial Statements for the years ended December 31, 2006, 2005 and 2004 (earlier periods are not required to be included).

For the purposes of the Consolidated Financial Statements included elsewhere in this Annual Report there are no differences between International Financial Reporting Standards issued by IASB and International Financial Reporting Standards adopted by the EU.

For a more complete description of the adoption of IFRS please see Item 5. Operating and Financial Review and Prospects 5.4 Adoption of International Financial Reporting Standards .

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

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|   | Year ended December 31,   |               |               |               |
|---|---|---------------|---------------|---------------|
|   | 2006  | 2006          | 2005          | 2004          |
|   | (millions of Euro, except   |               |               |               |
|   | percentages and per share   |               |               |               |
|   | amounts)  |               |               |               |
|   | (millions of U.S. dollars, except percentages and per share amounts)(1) |               |               |               |
| <b>Statement of Income Data in accordance with IFRS:</b>            |   |               |               |               |
| <b>Revenues</b>   | <b>41,274</b>   | <b>31,275</b> | <b>29,919</b> | <b>28,292</b> |
| <b>Operating income</b>   | <b>9,815</b>  | <b>7,437</b>  | <b>7,499</b>  | <b>7,603</b>  |
| <b>Net income from continuing operations</b>                        | <b>3,954</b>  | <b>2,996</b>  | <b>3,140</b>  | <b>2,952</b>  |
| Net income (loss) from discontinued operations/assets held for sale | 9   | 7             | 550           | (118)         |
| <b>Net income for the year</b>                                      | <b>3,963</b>  | <b>3,003</b>  | <b>3,690</b>  | <b>2,834</b>  |
| <i>of which:</i>  |   |               |               |               |
| • Net income attributable to equity holders of the Parent(2)        | 3,978   | 3,014         | 3,216         | 1,815         |
| • Net income (loss) attributable to Minority Interests              | (15)  | (11)          | 474           | 1,019         |
| <b>Financial Ratios in accordance with IFRS:</b>                    |   |               |               |               |
| Revenues/Employees (average number in Group) (thousands of ) (3)    | 516.0   | 391.0         | 374.6         | 355.4         |
| Operating income/Revenues (ROS)(%)                                  | 23.8  | 23.8          | 25.1          | 26.9          |
| <b>Basic and Diluted earnings per Share(4):</b>                     |   |               |               |               |
| • Ordinary Share  | 0.20  | 0.15          | 0.17          | 0.11          |
| • Savings Share   | 0.21  | 0.16          | 0.18          | 0.12          |
| <i>Of which:</i>  |   |               |               |               |
| <i>From continuing operations:</i>                                  |   |               |               |               |
| • Ordinary Share  | 0.20  | 0.15          | 0.14          | 0.12          |
| • Savings Share   | 0.21  | 0.16          | 0.15          | 0.13          |
| <i>From discontinued operations/assets held for sale:</i>           |   |               |               |               |
| • Ordinary Share  |   |               | 0.03          | (0.01)        |
| • Savings Share   |   |               | 0.03          | (0.01)        |
| <b>Dividends:</b>   |   |               |               |               |
| • per Ordinary Share  | 0.1848  | 0.1400(5)     | 0.1400        | 0.1093        |
| • per Savings Share   | 0.1993  | 0.1510(5)     | 0.1510        | 0.1203        |







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

|   | Year ended December 31,                                 |              |  |              |              |              |
|---|---|--------------|--|--------------|--------------|--------------|
|   | 2006  | 2006         | 2005   | 2004         | 2003         | 2002         |
|   | (millions of U.S. dollars, except per share amounts)(1) |              | (millions of Euro, except per share amounts) |              |              |              |
| <b>Statement of Income Data in accordance with U.S. GAAP:</b>   |   |              |  |              |              |              |
| • Revenues  | 41,274  | 31,275       | 29,921                                       | 28,292       | 27,290       | 26,769       |
| • Operating income  | 7,305   | 5,535        | 5,874  | 6,822        | 7,626        | 6,724        |
| • Net income (loss) before minority interests, discontinued operations / assets held for sale and cumulative effect of accounting changes | 2,261   | 1,713        | 1,962  | 2,899        | 3,064        | 6,272        |
| • Minority interests  | 47  | 36           | (479)  | (1,167)      | (1,523)      | (3,016)      |
| • Net income (loss) from discontinued operations / assets held for sale   | 149   | 113          | 409  | (191)        | 319          | (1,300)      |
| • Cumulative effect of accounting changes, net of taxes   |   |              | 47   | 0            | (19)         | 0            |
| • <b>Net income (loss) for the year (8)</b>   | <b>2,457</b>  | <b>1,862</b> | <b>1,939</b>                                 | <b>1,541</b> | <b>1,841</b> | <b>1,956</b> |
| <b>Basic and Diluted earnings per Ordinary Share(9):</b>  |   |              |  |              |              |              |
| • Net income (loss) after minority interests per Ordinary Share from continuing operations  | 0.11  | 0.08         | 0.08   | 0.10         | 0.17         | 0.80         |
| • Net income (loss) after minority interests per Ordinary Share from discontinued operations/assets held for sale                         | 0.01  | 0.01         | 0.02   | (0.01)       | 0.04         | (0.32)       |
| • Net income (loss) after minority interests per Ordinary Share from cumulative effect of accounting changes                              | 0.00  | 0.00         | 0.00   | 0.00         | (0.01)       | 0.00         |
| • <b>Net income (loss) per Ordinary Share</b>   | <b>0.12</b>   | <b>0.09</b>  | <b>0.10</b>                                  | <b>0.09</b>  | <b>0.20</b>  | <b>0.48</b>  |
| <b>Basic and Diluted earnings per Savings Share(9):</b>   |   |              |  |              |              |              |
| • Net income (loss) after minority interests per Savings Share from continuing operations   | 0.12  | 0.09         | 0.09   | 0.11         | 0.18         |              |
| • Net income (loss) after minority interests per Savings Share from discontinued operations/assets held for sale                          | 0.01  | 0.01         | 0.02   | (0.01)       | 0.04         |              |
| • Net income (loss) after minority interests per Savings Share from cumulative effect of accounting changes                               | 0.00  | 0.00         | 0.00   | 0.00         | (0.01)       |              |
| • <b>Net income (loss) per Savings Share</b>  | <b>0.13</b>   | <b>0.10</b>  | <b>0.11</b>                                  | <b>0.10</b>  | <b>0.21</b>  |              |

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

|   | As of December 31,            |                |                    |                |                |               |
|---|-------------------------------|----------------|--------------------|----------------|----------------|---------------|
|   | 2006                          | 2006           | 2005               | 2004           | 2003           | 2002          |
|   | (millions of U.S. dollars)(1) |                | (millions of Euro) |                |                |               |
| <b>Balance Sheet Data in accordance with U.S. GAAP:</b> |                               |                |                    |                |                |               |
| <b>Total assets</b>                                     | <b>152,206</b>                | <b>115,334</b> | <b>123,304</b>     | <b>106,919</b> | <b>108,335</b> | <b>93,367</b> |
| <b>Equity(10)</b>                                       | <b>57,833</b>                 | <b>43,823</b>  | <b>44,631</b>      | <b>34,827</b>  | <b>35,067</b>  | <b>15,221</b> |
| <b>Total liabilities(11)</b>                            | <b>94,373</b>                 | <b>71,511</b>  | <b>78,673</b>      | <b>72,092</b>  | <b>73,268</b>  | <b>78,146</b> |
| <b>Total equity and liabilities</b>                     | <b>152,206</b>                | <b>115,334</b> | <b>123,304</b>     | <b>106,919</b> | <b>108,335</b> | <b>93,367</b> |
| <b>Share capital(6)</b>                                 | <b>13,995</b>                 | <b>10,605</b>  | <b>10,599</b>      | <b>8,809</b>   | <b>8,798</b>   | <b>8,630</b>  |

**As of and for the year ended December 31,****Statistical Data:****Wireline:**

|  |        |        |        |        |        |
|--|--------|--------|--------|--------|--------|
| Fixed network connections in Italy (thousands)(12)             | 23,698 | 25,049 | 25,957 | 26,596 | 27,142 |
| Physical accesses (Consumer + Business) (thousands)            | 20,540 | 21,725 | 22,395 | 22,962 | 23,661 |
| Voice pricing plans (thousands)(13)                            | 6,468  | 6,321  | 5,883  | 5,547  | 5,224  |
| Broadband Accesses (thousands)(14):                            | 8,660  | 7,020  | 4,430  | 2,200  | 850    |
| • Domestic (thousands)   | 6,770  | 5,707  | 4,010  | 2,040  | 850    |
| • European, other than domestic (thousands)                    | 1,890  | 1,313  | 420    | 160    |        |
| Alice page views ex-Virgilio (millions)                        | 13,283 | 9,842  | 7,902  | 6,612  | 5,267  |
| Alice (ex-Virgilio) average monthly single visitors (millions) | 19.1   | 15.7   | 13.9   | 12.0   | 9.5    |

**Network infrastructure in Italy:**

|   |       |       |       |       |       |
|---|-------|-------|-------|-------|-------|
| • Access network in copper (millions of km pair)                                    | 105.7 | 105.2 | 105.2 | 105.2 | 104.3 |
| • Access network and transport in optical fibers (millions of km of optical fibers) | 3.7   | 3.7   | 3.7   | 3.6   | 3.6   |

**Network infrastructure outside Italy:**

|  |        |        |        |        |        |
|--|--------|--------|--------|--------|--------|
| • European backbone (km of optical fibers) | 51,000 | 51,000 | 39,500 | 39,500 | 36,600 |
|--|--------|--------|--------|--------|--------|

**Domestic Mobile:**

|   |        |        |        |        |        |
|---|--------|--------|--------|--------|--------|
| Mobile telephone lines in Italy at year-end (thousands) | 32,450 | 28,576 | 26,259 | 26,076 | 25,302 |
|---|--------|--------|--------|--------|--------|

**Brazil Mobile:**

|  |        |        |        |       |       |
|--|--------|--------|--------|-------|-------|
| Mobile telephone lines in Brazil at year-end (thousands) | 25,410 | 20,171 | 13,588 | 8,304 | 5,335 |
|--|--------|--------|--------|-------|-------|

**Media:**

|  |     |     |     |     |     |
|--|-----|-----|-----|-----|-----|
| La7 average audience share Free to Air (analog mode) for the year (%)              | 3.0 | 2.7 | 2.4 | 2.2 | 1.8 |
| La7 average audience share Free to Air (analog mode) for the month of December (%) | 3.1 | 3.1 | 2.6 | 2.2 | 2.1 |

(1) For the convenience of the reader, Euro amounts for 2006 have been converted into U.S. dollars using the Euro/Dollar Exchange Rate in effect on December 29, 2006 of 1.00 = U.S.\$ 1.3197.

- (2) For the purposes of IFRS, Parent, as used in this annual report, means Telecom Italia S.p.A..
- (3) The average number of employees in the Group (excluding employees relating to the consolidated companies considered as discontinued operations/assets held for sale and including personnel with temp work contracts) was 79,993, 79,869 and 79,602 in 2006, 2005 and 2004, respectively.
- (4) In accordance with IAS 33 Earnings per share, basic earnings per Ordinary Share is calculated by dividing the Group's net income available to shareholders by the weighted average number of shares outstanding during the year, excluding treasury shares.

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

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

- Ordinary Shares was 13,254,860,233 for the year ended December 31, 2006, 12,283,195,845 for the year ended December 31, 2005 and 10,208,327,613 for the year ended December 31, 2004;
- Savings Shares was 6,026,120,661 for the year ended December 31, 2006, 5,930,204,164 for the year ended December 31, 2005 and 5,795,921,069 for the year ended December 31, 2004.

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**Item 3. Key Information**

**Selected Financial And Statistical Information**

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

- (5) Telecom Italia's dividend coupons for the year ended December 31, 2006, were clipped on April 23, 2007 and were payable from April 26, 2007.
- (6) Share capital represents share capital issued net of the par value of treasury shares.
- (7) Net Financial Debt is a Non-GAAP Financial Measure as defined in Item 10 of Regulation S-K under the 1934 Act. For further details please see Item 5. Operating and Financial Review and Prospects 5.5 Results of Operations for the Three Years Ended December 31, 2006 5.5.2 Non-GAAP Financial Measures .
- (8) Refers only to Net income (loss) attributable to equity holders of the Parent.
- (9) In accordance with U.S. GAAP, the Net income (loss) per Ordinary Share has been calculated using the two class method, since the Company has both Ordinary Shares and Savings Shares outstanding. Under this method, set forth in Statement of Financial Accounting Standards No. 128, *Earnings per Share* , basic earnings per share is computed by dividing income available to shareholders by the weighted average number of shares outstanding. For the purpose of these calculations, the weighted average number of Ordinary Shares and Savings Shares was 13,254,860,233 and 6,026,120,661 for the year ended December 31, 2006, 12,283,195,845 and 5,930,204,164 for the year ended December 31, 2005, 10,208,327,613 and 5,795,921,069 for the year ended December 31, 2004 and 6,620,513,494 and 2,414,967,112 for the year ended December 31, 2003. The weighted average number of Ordinary Shares was 4,054,375,543 for the year ended December 31, 2002. The calculations take into account the requirement that holders of Savings Shares are entitled to an additional dividend equal to 2% of the par value of Savings Shares in addition to dividends paid on the Ordinary Shares. The calculations also take into account that in 2002 (after the redenomination of the share capital into Euro following the resolution taken by the Extraordinary Shareholders Meeting held on July 4, 2000) the par value of Ordinary Shares was 1 per share, and that in 2003, after the Merger, the par value of Ordinary Shares and Savings Shares was reduced to 0.55 per share. For diluted earnings per share the weighted average number of shares outstanding is increased to include any potential common shares and is adjusted for any changes to income that would result from the assumed conversion of those potential common shares.
- (10) Equity under U.S. GAAP refers only to Equity attributable to equity holders of the Parent.
- (11) Includes Minority Interests.
- (12) Data exclude internal lines.
- (13) Number of contracts; data include Teleconomy, Hellò and other Business voice offers.
- (14) Number of contracts.

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The determination of our future dividend policy, and the amounts thereof, will depend upon a number of factors, including but not limited to our earnings, financial condition and cash requirements, prospects and such other factors as may be deemed relevant at the time. Subject to the foregoing, we plan to pay dividends over the period 2007-2009 closer to the dividend policy of other European telecommunications operators.

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

| Year ended December 31, | Dividends on Ordinary Shares |                           |                    | Dividends on Savings Shares |                           |                    |
|-------------------------|------------------------------|---------------------------|--------------------|-----------------------------|---------------------------|--------------------|
|                         | U.S. dollars                 |                           |                    |                             |                           |                    |
|                         | Euro per Share               | U.S. dollars per Share(1) | (millions of Euro) | Euro per Share              | U.S. dollars per Share(1) | (millions of Euro) |
| 2002                    | 0.1357(2)                    | 0.1386                    | 713.47             | 0.1357(2)                   | 0.1386                    | 273.11             |

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

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

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

| Year ended December 31, | Dividends on Ordinary Shares |                           |                    | Dividends on Savings Shares |                           |                    |
|-------------------------|------------------------------|---------------------------|--------------------|-----------------------------|---------------------------|--------------------|
|                         | U.S. dollars                 |                           |                    |                             |                           |                    |
|                         | Euro per Share               | U.S. dollars per Share(1) | (millions of Euro) | Euro per Share              | U.S. dollars per Share(1) | (millions of Euro) |
| 2002                    |                              |                           |                    |                             |                           |                    |
| 2003                    | 0.1041                       | 0.1278                    | 1,072.95           | 0.1151                      | 0.1413                    | 667.11             |
| 2004                    | 0.1093                       | 0.1431                    | 1,225.99           | 0.1203                      | 0.1575                    | 697.25             |
| 2005                    | 0.1400                       | 0.1753                    | 1,873.12           | 0.1510                      | 0.1891                    | 909.94             |
| 2006(2)                 | 0.1400                       | 0.1903                    | 1,873.13           | 0.1510                      | 0.2052                    | 909.94             |

- 
- (1) Euro amounts have been translated into U.S. dollars using the Noon Buying Rate in effect on the respective payment dates.
- (2) Approved at the Annual Shareholders Meeting held on April 16, 2007. Pursuant to Italian Stock Exchange rules, dividends on the Ordinary Shares and the Savings Shares are payable from the fourth trading day after the third Friday of each month, and in any case, at least four business days after the Annual Meeting of Shareholders approving the dividends. Telecom Italia's dividend coupons for the year ended December 31, 2006 were clipped on April 23, 2007, and were payable from April 26, 2007.

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

According to the Italian Civil Code, before dividends may be paid with respect to any year, an amount equal to 5% of the net income of the Company for such year must be set aside to the legal reserve until the legal reserve, including amounts set aside during prior years, is at least equal to one-fifth of the par value of the Company's



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**Item 3. Key Information**

**Dividends**

issued share capital. This legal reserve is not available for payment of dividends. Such restriction on the payment of dividends applies, on a non-consolidated basis, to each Italian subsidiary of the Telecom Italia Group. The Company may also pay dividends out of available retained earnings from prior years or other reserves.

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

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

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

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

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

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

**Business**

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

**4.1 BUSINESS**

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

**4.1.1 BACKGROUND**

The legal and commercial name of the company is Telecom Italia S.p.A..

Telecom Italia is a joint-stock company established under Italian law with registered offices in Milan at Piazza degli Affari 2. The company is recorded in the Milan Companies Register at number 00488410010, R.E.A. number 1580695.

The duration of the company, as stated in the company's Bylaws, extends until December 31, 2100.

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 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.

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On August 4, 2003, Old Telecom Italia merged with and into Olivetti (the **Merger**) with Olivetti as the surviving company changing its name to Telecom Italia S.p.A. . Following the Merger, the proportionate ownership of Telecom Italia's share capital by shareholders unaffiliated with Olimpia or Pirelli & C. S.p.A. (Pirelli), Olimpia's largest shareholder, increased substantially to approximately 88.43% of the outstanding Ordinary Shares. Following the Merger, Olimpia acquired additional shares through market purchases and, prior to the acquisition by Telecom Italia of the share capital in TIM it did not already own (the **TIM Acquisition**), Olimpia held approximately 17% of Telecom Italia's Ordinary Shares, making it the largest shareholder of Telecom Italia. As a result of a series of transactions in December 2004 and March 2005, Olimpia acquired additional Ordinary Shares resulting in ownership of approximately 21.4% of the outstanding Ordinary Shares.

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

Currently 80% of the share capital of Olimpia is held by Pirelli & C. S.p.A., with the remaining stake owned by Sintonia S.p.A. that replaced Edizione Holding S.p.A. as a result of its demerger (effective as of March 2, 2007) and by Sintonia S.A., previously named Edizione Finance International S.A., a wholly owned subsidiary of Sintonia S.p.A..

According to publicly available filings with CONSOB, as of June 13, 2007, the shareholders of Pirelli with a 5% shareholding or greater in Pirelli's voting capital were Camfin CAM Finanziaria S.p.A. (25.387%) and Assicurazioni Generali S.p.A. (5.251%). On the same date shareholders of Camfin CAM Finanziaria S.p.A. with a 5% shareholding or greater in the voting capital of the company included Mr. Marco Tronchetti Provera (through Gruppo Partecipazioni Industriali S.p.A. (50.180%)) and Mr. Carlo Acutis (through Vittoria Assicurazioni S.p.A. (4.648%) and Yura International Holding B.V. (4.649%)).

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

**Business**

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

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

On April 28, 2007 Pirelli & C. S.p.A., Sintonia S.p.A. and Sintonia S.A. announced by press release that they had reached an agreement with a group of institutional financial investors and Telefónica S.A., the Spain-based international telecoms operator for the sale of 100% of the share capital of Olimpia.

The acquisition (which is conditional upon the authorizations and approvals of competent authorities) will be effected by a vehicle company (Telco S.p.A.) owned by Assicurazioni Generali S.p.A. (28.1%), Intesa Sanpaolo S.p.A. (10.6%), Mediobanca S.p.A. (10.6%), Sintonia S.A. (8.4%) and Telefónica S.A. (42.3%). The transaction is expected to be completed by October 2007.

Telco S.p.A., after the acquisition and the incorporation of Olimpia, will hold approximately 23.6% of the voting share capital of Telecom Italia, 18% of which will be acquired with the acquisition of Olimpia and 5.6% of which will be contributed by Assicurazioni Generali S.p.A. and Mediobanca S.p.A..

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

Business

The following chart illustrates the expected ownership structure following completion of the transaction.

#### 4.1.2 DEVELOPMENT

Olivetti (now Telecom Italia) was founded in Ivrea (Province of Turin) in 1908 as a typewriter manufacturing company. Subsequently, Olivetti gradually altered its core business from office products (mechanical products at first and electronic products later) to products for information technology and telecommunications.

In May 1999, after the completion of a purchase and exchange offer, Olivetti and its subsidiary Tecnost S.p.A. acquired control of the old Telecom Italia, Italy's main telecommunications operator, which, had previously held the monopoly for such operations and had been state-controlled until its privatization in 1997.

In August 2003, Old Telecom Italia was merged into Olivetti; Olivetti adopted Telecom Italia's corporate purpose and name.

In June 2005, TIM (a separate company listed on the Italian stock exchange, controlled by Telecom Italia, engaged in mobile communications services) was merged into Telecom Italia, after the spin-off of the corporate operations relating to the domestic mobile communications business to Tim Italia, a wholly-owned subsidiary of TIM and, after TIM's merger into Telecom Italia, of Telecom Italia.

During the course of 2005, activities in the Internet sector, which were under the control of Telecom Italia Media, were also integrated into Telecom Italia through the acquisition of the assets of Virgilio (through the companies Finanziaria Web and Matrix) and Tin.it (through the company Nuova Tin.it).

The final stage in this reorganization process took place in October 2005 when the Telecom Italia Board of Directors decided to adopt a new business model based on the integration of its wireline and mobile businesses (the so-called **One Company Model**). In line with this decision, Tim Italia was merged in Telecom Italia (with effect from March 1, 2006). The One Company Model also led to the integration of the Internet activities in the parent company and, in the second half of 2006, the wholly-owned subsidiary Nuova Tin.it S.r.l. was merged into Telecom Italia with effect from October 1, 2006.

The adoption of the One Company Model was our strategic response to changes in the demand for telecommunications services, increased competitive pressure and technological innovations, which were progressively erasing the traditional distinctions between fixed and mobile business areas. We considered at the time that our ability to offer wireline, mobile and Internet services, as the demand for these services converged, provided us with a longer term competitive advantage which, if exploited, would be the

means of achieving our targets of growth and profitability.

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

**Business**

Given the opportunities offered by the market and technology (especially the focus on the integration between broadband and media content) and the regulatory constraints placed on the Group's activities, in September 2006, the Board of Directors elected to separate the mobile telephony operations and local access network business, and to create specific business divisions focused on various market and services segments.

Subsequently, on January 22, 2007, the Telecom Italia Group implemented a new organizational plan which, while implementing a strategy that gives strong value to Fixed-Mobile convergence as a distinctive advantage, is aimed at maintaining a focused approach to the various markets, as they are still characterized by specific competitive and regulatory contexts.

For more detail about the organizational structure deriving from this approach, please see 4.1.8 The Organizational Structure .

**4.1.3 BUSINESS**

The Telecom Italia Group is engaged principally in the communications sector and, particularly, in telephone and data services on fixed lines, for final retail customers and wholesale providers, in the development of fiber optic networks for wholesale customers, in innovative broadband services, in Internet services, in domestic and international mobile telecommunications (especially in Brazil), in the television sector using both analog and digital terrestrial technology and in the office products sector, and operates mainly in Europe, the Mediterranean Basin and in South America.

In particular, at December 31, 2006, the Telecom Italia Group was one of the world's largest wireline operators, with approximately 23.7 million fixed network connections in Italy. In addition, the Telecom Italia Group was the leading mobile operator in Italy, with 32.4 million domestic mobile telephone lines at December 31, 2006; and as of the same date Telecom Italia Group had 25.4 million mobile telephone lines in Brazil. We have significantly expanded into broadband in recent years and, at December 31, 2006, we had 8.7 million broadband accesses, 6.8 million in Italy and 1.9 million elsewhere in Europe (France, Germany and The Netherlands).

**4.1.4 DISPOSALS AND ACQUISITIONS OF SIGNIFICANT EQUITY INVESTMENTS IN 2006**

For a description of disposals and acquisitions of significant equity investments in 2006 please see Note 1 Form and Content and Other General Information , Note 3 Business Combinations, Acquisitions of Minority Interests and Transactions between Companies Under Common Control , Note 8 Other Non-Current Assets and Note 16 Discontinued Operations/Assets Held for Sale of the Notes to the Consolidated Financial Statements.

**4.1.5 RECENT DEVELOPMENTS DURING 2007**

**Entel Bolivia**

The Bolivian government, in pursuing its policy of nationalizing various privately-owned businesses, including Entel Bolivia (acquired in 1995 by the Telecom Italia Group through the Dutch subsidiary ETI, entirely controlled by Telecom Italia International), recently issued a decree establishing a ministerial commission in order to start, conduct and conclude negotiations, within 30 days beginning from the publication of the decree, aimed at recovering Entel Bolivia for the State. The above-mentioned measure alleges that Entel Bolivia and ETI have committed a number of serious administrative and fiscal irregularities. Telecom Italia participated in the meetings with the commission with the sole aim of hearing the government's position with regard to the recovery of Entel Bolivia, but rejected all the allegations concerning the supposed irregularities. Subsequently, on April 23, 2007, the Bolivian government adopted two more measures cancelling all the previous laws which were the basis on which the previous government had acknowledged that Entel Bolivia had fulfilled all the obligations it had assumed when the company was privatized, declaring that all initiatives taken in executing the abrogated laws (particularly the capital reduction of Entel Bolivia resolved at the end of 2005) would be punishable by law, and also annulled a number of further administrative measures, particularly the one passed in 1995, which had launched the Entel Bolivia privatization process.

On April 30, 2007, as a reaction to the position assumed by the commission and the measures adopted by the Bolivian government, and with the aim of protecting its interests in the country, ETI notified the government of its intention to start the procedure provided for in the bilateral treaty for the protection of investments between Bolivia and The Netherlands; upon such notification, the parties may initiate consultation procedures for six months with a view to settling amicably the conflict between them. This action is preliminary to the possibility of asking the International Center for Settlement of Investment Disputes (ICSID), an internal body of the World Bank, to start an international arbitration to resolve the dispute.



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

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***Change in Ownership Structure***

On April 28, 2007 Pirelli & C. S.p.A., Sintonia S.p.A. and Sintonia S.A. reached an agreement with a group of institutional financial investors and Telefónica S.A., the Spain-based international telecoms operator, for the sale of 100% of the share capital of Olimpia. For a description of the Olimpia sale please see 4.1.1. Background .

***Consultation regarding fixed line network by the National Regulatory Authority***

For a discussion of the consultation being held by the NRA with regard to Telecom Italia's domestic fixed line network please see 4.3 Regulation .

For a description of other recent developments please also see Note 44 Events Subsequent to December 31, 2006 and Note 48 Additional U.S. GAAP Disclosures of the Notes to the Consolidated Financial Statements.

**4.1.6 OVERVIEW OF THE TELECOM ITALIA GROUP'S MAJOR BUSINESS AREAS**

The following is a chart of the Telecom Italia Group's Business Units as of December 31, 2006:

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The table below sets forth revenues, operating income (loss), capital expenditures and number of employees by Business Units, for the periods indicated:

|                                    |         | Wireline<br>(1)                                | Domestic<br>Mobile | Brazil<br>Mobile | Media | Olivetti | Other<br>activities<br>(1)(2) | Adjustments<br>and<br>eliminations | Consolidated<br>Total |
|------------------------------------|---------|--|--------------------|------------------|-------|----------|-------------------------------|------------------------------------|-----------------------|
|                                    |         | (millions of Euro, except number of employees) |                    |                  |       |          |                               |                                    |                       |
| Revenues(3)                        | 2006    | 17,795   | 10,210             | 3,964            | 207   | 440      | 1,563                         | (2,904)                            | <b>31,275</b>         |
|                                    | 2005(4) | 17,834   | 10,076             | 2,900            | 180   | 452      | 1,321                         | (2,844)                            | <b>29,919</b>         |
|                                    | 2004(4) | 17,508   | 9,923              | 1,800            | 168   | 590      | 1,289                         | (2,986)                            | <b>28,292</b>         |
| Operating income (loss)            | 2006    | 4,396  | 3,742              | 21               | (137) | (50)     | (582)                         | 47                                 | <b>7,437</b>          |
|                                    | 2005(4) | 4,488  | 3,856              | (190)            | (130) | (38)     | (547)                         | 60                                 | <b>7,499</b>          |
|                                    | 2004(4) | 4,709  | 4,010              | (137)            | (93)  | 17       | (692)                         | (211)                              | <b>7,603</b>          |
| Capital expenditures               | 2006    | 3,002  | 1,146              | 699              | 85    | 10       | 200                           | (28)                               | <b>5,114</b>          |
|                                    | 2005(4) | 2,823  | 1,276              | 842              | 65    | 19       | 156                           | (8)                                | <b>5,173</b>          |
|                                    | 2004(4) | 2,449  | 1,469              | 817              | 39    | 15       | 213                           |                                    | <b>5,002</b>          |
| Number of employees at year-end(5) | 2006    | 55,705   | 11,218             | 9,531            | 919   | 1,428    | 4,408                         |                                    | <b>83,209</b>         |
|                                    | 2005(4) | 56,987   | 11,720             | 9,043            | 886   | 1,750    | 5,098                         |                                    | <b>85,484</b>         |
|                                    | 2004(4) | 55,833   | 11,767             | 6,967            | 1,077 | 2,109    | 4,867                         |                                    | <b>82,620</b>         |

(1) As a result of the new organizational structure of the Group approved on October 5, 2005 (the so-called **One Company Model**), the activities of the Innovation & Engineering Services business segment of Telecom Italia, ex-TILAB segment of Telecom Italia, previously included in Other activities, were transferred to the Wireline Business Unit; therefore 2005 and 2004 results have been reclassified for purposes of comparison.

(2) Entel Bolivia group is included in Other Activities.

(3) 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).

(4) The data relating to 2005 and 2004 have been reclassified and presented consistent with the 2006 presentation.

(5) The number of employees at year-end excludes employees relating to the consolidated companies considered as discontinued operations/assets held for sale, and includes personnel with temp work contracts.

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The following table sets forth, for the periods indicated, certain selected statistical data for the Telecom Italia Group's Business Units.

|   | As of and for the year ended<br>December 31, |        |        |
|---|--|--------|--------|
|   | 2006   | 2005   | 2004   |
| <b>Statistical Data:</b>  |  |        |        |
| <b>Wireline:</b>  |  |        |        |
| Fixed network connections in Italy (thousands)(1)                                   | 23,698                                       | 25,049 | 25,957 |
| Physical accesses (Consumer + Business) (thousands)                                 | 20,540                                       | 21,725 | 22,395 |
| Voice pricing plans (thousands)(2)  | 6,468  | 6,321  | 5,883  |
| Broadband Accesses (thousands)(3):  | 8,660  | 7,020  | 4,430  |
| • Domestic (thousands)  | 6,770  | 5,707  | 4,010  |
| • European, other than domestic (thousands)   | 1,890  | 1,313  | 420    |
| Alice page views ex-Virgilio (millions)   | 13,283                                       | 9,842  | 7,902  |
| Alice (ex-Virgilio) average monthly single visitors (millions)                      | 19.1   | 15.7   | 13.9   |
| <b>Network infrastructure in Italy:</b>   |  |        |        |
| • Access network in copper (millions of km pair)                                    | 105.7  | 105.2  | 105.2  |
| • Access network and transport in optical fibers (millions of km of optical fibers) | 3.7  | 3.7    | 3.7    |
| <b>Network infrastructure outside Italy:</b>  |  |        |        |
| • European backbone (km of optical fibers)  | 51,000                                       | 51,000 | 39,500 |
| <b>Domestic Mobile:</b>   |  |        |        |
| Mobile telephone lines in Italy at year-end (thousands)                             | 32,450                                       | 28,576 | 26,259 |
| <b>Brazil Mobile:</b>   |  |        |        |
| Mobile telephone lines in Brazil at year-end (thousands)                            | 25,410                                       | 20,171 | 13,588 |
| <b>Media:</b>   |  |        |        |
| La7 average audience share Free to Air (analog mode) for the year (%)               | 3.0  | 2.7    | 2.4    |
| La7 average audience share Free to Air (analog mode) for the month of December (%)  | 3.1  | 3.1    | 2.6    |

(1) Data exclude internal lines.

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

(3) Number of contracts.

**4.1.7 UPDATED STRATEGY**

On March 9, 2007, we set out our priorities for the 2007-2009 period.

Changes in the demand for telecommunications services, increased competitive pressure and technological breakthroughs continue to erode the traditional distinctions between fixed and mobile business areas and convergence increasingly appears as the means of developing a sustainable long-term competitive advantage.

After an initial phase in 2005-2006 in which we built a fully integrated business model, we have now evolved our organizational model focusing on business segments and flexibility, preserving the integrated approach in network infrastructures development and in platforms and systems management and development.

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

- **Maintain clear leadership in Domestic TLC market:**

increasing broadband penetration and continuing our win back and retention strategy based on dual play (voice and broadband access) and triple play (voice, broadband access and IPTV) offers for private customers and integrated solutions (voice, broadband and value added services **VAS**) for business customers in the domestic fixed market;

developing a volume and value strategy in the domestic mobile market based on market and offer segmentation, the migration towards 3G/High Speed solutions to exploit VAS growth and the push on flat and post-paid (contract) offers;

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leveraging fixed-mobile convergent offers (a bundle of fixed and mobile services) in voice, VAS and broadband as a distinguishing factor in market positioning versus other operators;

leading network evolution towards full IP and ultra broadband to maintain leadership in service innovation and to efficiently manage future business evolutions;

pushing on efficiency in all costs areas to protect Telecom Italia's domestic profitability exploiting full-IP network architecture simplification and consolidating convergent synergies.

- **Exploit the increasing growth opportunity in adjacent sectors (Content, Information and communication technology ICT):**

developing an IPTV service offer to increase the Average Revenue Per User ( **ARPU** ) and the share of wallet on broadband customers and to accelerate broadband adoption and penetration;

exploit network capabilities and strong Telecom Italia relationships with its business customer to push on ICT value added services as a means to increase customer loyalty.

- **Strongly increase the weight of international operations through the development of European broadband presence and the consolidation of Latin-American operations:**

strengthening and developing existing broadband activities in Europe and also exploiting high potential incremental businesses (virtual mobile operator model, service multinational corporations) that can leverage on local presence in Germany, France and The Netherlands;

maintaining leadership in mobile growth in Brazil by launching Fixed-Mobile convergent offers in order to defend TIM from alternative convergent offers (a bundle of fixed and mobile services) and attract high value customers (fixed and mobile);

anticipate the consolidation of Telecom Argentina operations (Telecom Italia owns 50% of Sofora Telecomunicaciones S.A. and owns call options rights to acquire control from 2009) to strengthen Latin-American presence.

While implementing a strategy that gives strong value to fixed-mobile convergence (a bundle of fixed and mobile services) as a distinctive advantage, we therefore maintain a focused approach to the fixed and mobile markets, which are still characterized by specific competitive and regulatory contexts.

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

**Wireline business**

In Wireline, the main focus is on broadband development and customer retention. At the end of 2006, the customer base of broadband access lines was 6.8 million in the domestic market and 1.9 million in the European markets (France, Germany and The Netherlands). Broadband access services (Alice and Alice Business) have supported continued growth. New voice packages, including flat rates on both the Public Service Telephony Network ( **PSTN** ) and VoIP lines, and innovative integrated solutions for business clients were also introduced.

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

In particular, we intend to:

- maintain the domestic leadership in our core business (voice services, Internet access, data transmission services for businesses, national and international wholesale services); on voice, the process of migrating an increasing portion of our customers to flat rate packages will be a key to ensure the success of our retention strategy;
- strengthen our leadership in service innovation and increase the penetration of broadband services, through dual play offers, triple play offers, and also quadruple play offers (fixed and mobile voice, broadband access and IPTV);

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- innovative services will be supported by increased bandwidth (>50Mbit/s on fixed infrastructure and 10Mb/sec on mobile infrastructure), as we expect to lead network evolution towards full IP and ultra broadband characterized by:

Introduction of Fibre and VDSL2 technology in the access network;

Significant extension of ADSL2+ / triple play coverage to anticipate Fttx (optical fiber based) solutions;

Implementation of a full IP network;

Progressive full migration to Telephony Over Internet Protocol ( **ToIP** ) starting from 2009;

Development of new data centers and platforms to support new vertical services distribution;

- consolidate our operational capabilities with the objective of offering top high quality service levels to our customers and leverage opportunities to retain our client base by enhancing customer loyalty (through customer relationship management and customer contact);
- run efficient operations and continue to be focused on cost-cutting and cost control (personnel, real estate, general and administrative, network).

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

***Italian mobile business***

Mobile Italy s strategy is based on a volume and value approach and is focused on maintaining leadership on Mobile market and achieving sustainable and profitable growth through:

- continuous innovation and improved segmentation of voice and Value Added Services (VAS) offers; we believe this should enable Telecom Italia to retain or improve its market share and to achieve leadership in the UMTS services market;
- strong customer care, able to respond and anticipate customer needs with a segmented approach; and
- full enhancement of the potential of the UMTS network and development of mobile broadband technologies (such as HSDPA High-Speed Downlink Packet Access: a UMTS evolution that allows broadband connections up to 3.6 Mbps) and of DVB-H (Digital Video Broadcasting-Handheld: a technology used to broadcast digital video to mobile devices) services. These are expected to enable the provision to mobile customers of value added services and content now

available to fixed line customers, due to the development of convergent platforms.

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

- focusing on the high end of the market, attracting valuable customers and leveraging caring differentiation and loyalty programs;
- accelerating innovative marketing propositions, aimed at generating new and segmented offers to increase voice traffic and VAS usage; penetration of mobile internet, access to premium and user generated content;
- a multichannel and integrated approach to caring and distribution, tailored for different customer needs/profile;
- development of synergies between fixed and mobile services both on the revenue side, by launching convergent services, and on the cost side, by continuing to eliminate duplication and achieving cost efficiencies on capital expenditures and operating expenditures;
- focus on innovative capital expenditures, enabling us to retain our leadership in network quality and to provide our customers with attractive wireless broadband services.

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



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***European Broadband Project***

European broadband development represents increasingly a key driver in Telecom Italia's overall growth strategy. Telecom Italia will continue to strengthen and develop existing activities and monitor any opportunities to exploit potential incremental business (i.e. MVNO - Mobile Virtual Network Operator, a company that provides mobile telephone services without its own infrastructures - services to multinational companies) that can leverage on local capabilities (sales, backbone and access network) and centralized support.

Telecom Italia's European presence is today focused on Germany, France and The Netherlands. In particular on single country basis, Telecom Italia's strategy is set upon the following guidelines:

- **In Germany.** Telecom Italia will leverage on its AOL acquisition to consolidate growth, profitability and cash generation. The main strategic tools in Germany are:

develop new VoIP and triple play offers;

leverage on brand and sales efficiency;

expand Local Loop Unbundled ( **LLU** ) coverage to maximise returns from market growth (from 40% at the end of the year 2006 to 68% at the end of the year 2009);

launch MVNO.

- **In France.** Telecom Italia has completed a 12 months industrial turn around to achieve operating and economic efficiency. The main strategic tools in France are:

develop new VoIP, triple play, quadruple play offers (new mediabox, rich portfolio of IPTV paying channels; launch of Video On Demand services);

maximum commercial focus on Local Loop Unbundled areas;

increase quality of service and of end-to-end process management;

Local Loop Unbundled coverage expansion (from 36% at the end of the year 2006 to over 50% by middle 2008);

Wimax (Worldwide Interoperability for Microwave Access, a technology used to provide wireless broadband access) and MVNO (Mobile Virtual Network Operator, a company that provides mobile telephone services without

its own infrastructures) options.

***Brazilian Mobile business (Tim Brasil)***

In 2006, Tim Brasil continued to strengthen its market position and outperformed the Brazilian market line growth due to its ability to attract high value customers. The Brazilian market has been characterized by strong growth in recent years and is expected to continue to grow, although such residual market growth is predominantly in lower income social classes. Tim Brasil's strategy will be focused on:

- consolidating its position (revenue growth consistently above market average), and increasing profitability;
- ensuring profitability of low ARPU clients;
- capturing fixed-line revenues (increase share of spending on Tim Brasil customer base) and defend TIM mobile leadership.

Tim Brasil will endeavor to reach these strategic objectives through:

- end-to-end segmentation to attract and maintain high value consumer and business customers;
- operational efficiency to support customer base expansion;
- development of a new business model oriented to low-ARPU customers;
- development of new convergent products (such as home zone with fixed numbering, Virtual PABX, Internet broadband access, etc.);
- continuous innovation in VAS;

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- shorter time to market and greater efficiency due to Tim Brasil's plug and play strategy, which enables it to share resources and know-how with the domestic Italian business;
- improved customer care and leveraging on its extensive distribution channel;
- continued focus on quality of coverage.

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

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

**4.1.8 THE ORGANIZATIONAL STRUCTURE**

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

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The organizational structure of Telecom Italia Group at December 31, 2006 was as follows:

- **Central functions**, organized according to Group Functions and/or Service Units, which were in charge of directing the operations of the Group;
- **Operations and Business Units**, which were responsible for business development and activity coordination for the reference market.

The following reported to the then Chairman of the Board of Directors, Guido Rossi:

- the *Public Affairs* Group function;
- *General Counsel*.

The following reported to the Executive Deputy Chairman, Carlo Orazio Buora:

- the Chief Executive Officer of *Operations*, Riccardo Ruggiero, who was responsible for ensuring the management and development of the fixed telecommunications, mobile telecommunications and Internet services businesses;
- the *Media* and *Olivetti* Business Units;
- the Group Functions of *Advertising & Image, Brand Enrichment (Progetto Italia), Investor Relations, Finance Administration and Control, Human Resources, Organization and Security, Corporate and Legal Affairs, International Legal Affairs, Corporate Development, Purchasing, Services for the Judicial Authorities and IT Governance, External Relations and Economic Studies*;
- *Telecom Italia Audit and Compliance Services* and *Telecom Italia Latam*.

The *Support Activities* function also reported directly to the Executive Deputy Chairman.

\*\*\*

On January 22, 2007, the Telecom Italia Group implemented an organizational plan aimed at adapting its strategy to the evolution and advances in technology, the market, the competition and the regulatory developments as well as fostering the convergence of

the business areas (fixed-mobile, fixed-media, communication and information technology), while maintaining autonomy and flexibility.

Under this new organizational structure, the following **Group Functions** reported to the Chairman of the Board of Directors:

- *Public Affairs;*
- *General Counsel & Corporate and Legal Affairs.*

The following reported to the Executive Deputy Chairman:

- the **CEO** of Telecom Italia, to whom the following reported:

*the Domestic Fixed Services Department*, with responsibility for ensuring at a national level the development and management of activities relating to wireline telecommunications for consumer and business customers;

*the Domestic Mobile Services Department*, with responsibility for ensuring at a national level the development and management of activities relating to mobile telecommunications for consumer and business customers;

*the Top Clients & ICT Services Department*, with responsibility for ensuring the development and management of activities relating to fixed telecommunications and mobile telecommunications and the relative ICT services for TOP customers;

*the Technology Department*, with responsibility for ensuring the technological innovation of the Group, as well as the development and operation of the fixed and mobile telecommunications networks, systems and IT infrastructures;

*Tim Brasil*, with responsibility for ensuring the development and management of the mobile telecommunications business in Brazil;

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*Quality & Field Services Management*, with responsibility for ensuring control over delivery processes and technical assistance to the customers, as well as the monitoring of customer satisfaction and the coordination of plans for improving the quality of service;

*National Wholesale Services*, with responsibility for ensuring the management of relations with domestic licensee operators;

*International Wholesale and Broadband Services*, with responsibility for ensuring the development of the international wholesale business of the Group and also the coordination of broadband operations outside Italy;

*and also Business Development and Regulatory Affairs Functions;*

- the **Media** Business Unit;
- the **Olivetti** Business Unit;
- the **Group Functions**: *Finance, Administration and Control, Human Resources, Organization and Security, Domestic Legal Affairs and Services for the Judicial Authorities, International Legal Affairs, Purchasing, Strategy, External Relations, International Affairs and Investor Relations.*

In addition, *Telecom Italia Audit and Compliance Services*, reported to the Executive Deputy Chairman.

On February 16, 2007, the Telecom Italia Board of Directors appointed Massimo Castelli (*Domestic Fixed Services Department*), Luca Luciani (*Domestic Mobile Services Department*), Enrico Parazzini (*Finance, Administration and Control Function*) and Stefano Pileri (*Technology Department*) as General Managers.

\* \* \*

On April 6, 2007 Guido Rossi resigned from the positions of Chairman and member of the Board of Directors of Telecom Italia S.p.A. Following the shareholders' meeting held on April 16, 2007, the newly elected Board of Directors of Telecom Italia held its first meeting on April 17, 2007 and appointed Mr. Pasquale Pistorio as Chairman and confirmed Mr. Carlo Orazio Buora as Executive Deputy Chairman and Mr. Riccardo Ruggiero as Chief Executive Officer. Subsequently, the Board of Directors confirmed the corporate responsibilities described above except that the Chairman, who is the legal representative of the Company, was also given the responsibility for:

- overseeing the process of examination and definition of the strategic guidelines for the Company and the Group, with the assistance of the Executive Deputy Chairman and the Chief Executive Officer;

- proposing the strategic guidelines, so defined, to the Board of Directors; and
- overseeing the development of the industrial plans and related implementation processes.

This additional responsibility was in addition to the organizational responsibility for the coordination of the Functions of Group General Counsel and Corporate and Legal Affairs, Public Affairs and Strategy.

The roles of the Executive Deputy Chairman and the Chief Executive Officer remained as described above.

### ***Committees***

One of the most important tools for the management and operational integration of the Group is the *Committee System*, which aims at:

- monitoring the implementation of strategies and the development of plans and results;
- ensuring the overall coordination of business actions and management of the relative cross-over business issues;
- building up the necessary operating synergies between the various functions involved in the technological, business and support processes; and
- supporting the integrated development of the innovation processes of the Group.

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In particular, as of December 31, 2006, the *Committee System* of the Group included:

- the *Management Committee*, which coordinated the Group's activities and ensured a unitary approach to the development and implementation of business strategies;
- the *Investments Committee*, which was entrusted with approving investments that exceeded specific delegated limits;
- the *Business Reviews Committee for Operations, Media and Olivetti* which, for each business segment, analyzed forecasts, results and operating progress and examined the progress made on the most important projects and action plans;
- the *Technological Innovation Committee*, which ensured an integrated approach to innovation and technological development processes;
- the *IT Governance Committee*, which defined the guidelines for the information strategies of the Group, guided IT strategic decisions and investments consistently with business needs, monitored progress on the most important IT projects, the quality of solutions and cost effectiveness; and
- the *Risk Management Committee*, which ensured the identification, the assessment and the management of risks of the Group, coordinating preventive action plans designed to ensure the operating continuity of the business.

To date, as a result of the new organizational structure, the Committee System of the Group is under re-examination and renewal.



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On October 5, 2005, the Board of Directors of Telecom Italia adopted the One Company Model organizational structure by converging the two previous Wireline and Mobile Business Units into one single unit (Operations).

For purposes of accounting representation, starting from the first half of 2006, Mobile activities have been divided into Domestic Mobile and Brazil Mobile.

Operations is organized as follows:

| Operations      |
|-----------------|
| Wireline        |
| Domestic Mobile |
| Brazil Mobile   |

**4.2.2 WIRELINE**

On a national level, the Wireline Business Unit operates as the consolidated market leader of wireline telephone and data services for final customers (retail) and other operators (wholesale). On an international level, the Wireline Business Unit develops fiber optic networks for wholesale customers (in Europe, in the Mediterranean area and in South America) and also offers innovative broadband services in France, Germany and The Netherlands.

The organizational structure of the Wireline Business Unit as of December 31, 2006 was as follows:

| Telecom Italia Wireline | Wireline<br>National Subsidiaries | International Subsidiaries      |
|-------------------------|-----------------------------------|---------------------------------|
| Wireline TLC services:  | Loquendo S.p.A.                   | BBNED group                     |
|                         | Matrix S.p.A.                     | Liberty Surf group              |
| • Retail telephone      | Path. Net S.p.A.                  | HanseNet Telekommunikation GmbH |

Telecontact Center S.p.A.

- Internet
- Data Business
- National Wholesale

Telecom Italia Sparkle group:

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

- TIS France S.A.S.

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- The Wireline Business Unit is focused on encouraging its customers to migrate towards innovative technologies which provide access to a new generation of IP services and applications. In 2006, the Wireline Business Unit aimed at expanding the penetration of ADSL into the retail broadband market through its range of Alice products offered to consumers, SOHOs (Small Office Home Offices) and SMEs (Small-and Medium- size Enterprises).
- At December 31, 2006, this strategy had achieved significant success with a broadband retail and wholesale portfolio of 6.8 million broadband points of access (compared to approximately 5.7 million broadband points of access at December 31, 2005), of which approximately 5.6 million had been sold to retail broadband customers. Throughout 2006, Telecom Italia's sales strategy aimed at encouraging customers with pay per use rate plans to migrate towards flat rate plans and voice/data bundle packages. Such plans now constitute approximately half of Telecom Italia's retail broadband customers.
- The Wireline Business Unit is continuing to develop new services to offset the decline in traditional services. On the Consumer market, the IPTV service was launched with a geographical coverage of 250 cities by the end of 2006. In addition, Telecom Italia continued to develop its range of Internet content and services and its range of advanced telephony such as video-communication and VAS. In the business market, Telecom Italia efforts are focused on offering to its customers ICT solutions, as a tool to promote customer retention and increase revenues.
- In the traditional voice business, the main strategy has been to increase the penetration of flat voice packages, to achieve higher retention rates among existing customers and win back customers who have moved to other service operators.

**V WIRELINE STRATEGIC BUSINESS AREAS**

- ***Retail Telephone***

Retail telephone services consist mainly of the supply of services using traditional technologies (PSTN and ISDN) and innovative technologies (VoIP). Retail telephone services include: network access, traffic (in terms of minutes and rate plans), hire of telephone equipment and value added telephone services.

**Traditional access.** In 2006 the new Linea Più package of services was launched. This package is aimed at sustaining the demand for new telephone lines and at increasing the penetration of Broadband and the use of services. The new package includes an additional VoIP number, a modem for surfing the Internet, the Tutto 4\* services package and free consultation of the 1254 automatic subscriber information service.

For business customers, especially SOHO customers, there was a move towards VoIP lines, with a flat rate for national calls.

**Pricing (rate plans).** In addition to activities aimed at increasing the number of flat rate packages, we expanded our portfolio of pricing plans by extending the concept of *parli per 0 eurocents* to the fixed-mobile segment. One of such pricing plans, Teleconomy Zero-Zero, enables customers to call or make video calls for 0 eurocents a minute, both to fixed and mobile phones with a connection charge when the phone is answered.

We launched rate plans to encourage convergence with the mobile network, with a special promotion of the Team Business and Teleconomy One Office rate plans, which provide subscribers with a free of charge first month.

**Products.** For the Business customers, the *VoIP* cordless model of the Aladino was launched, bundled with Alice Business Voice, the new entry level fax Pegaso MMS, and a new range of personal computers.

- ***Retail Internet***

Retail Internet services consist mainly of ADSL services (connections, traffic, services, equipment and portals) and traditional Internet traffic (dial-up access).

**Internet and VoIP Alice.** We introduced promotions on Alice Free to encourage customers to switch to ADSL by eliminating fixed costs for customers.

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We launched the Unica rate plan, the first integrated TIM-Telecom package, which allows VoIP calls from the Wi-Fi connection of Alice inside the home and GSM TIM calls outside the home using a TIM UNICO cell phone.

We launched the double and triple play Alice Tutto Incluso rate plans which, starting at a price of 1 a day, offers customers Internet with speeds of up to 20 Mega, unlimited phone calls and video calls from the new Video telephone and personally selected TV programs. Customers also have the option of buying a season ticket for the TIM Serie A Soccer Championship or a portable PC with zero interest, including installation.

For the Business customers, there is a drive to promote VoIP associated with entry level ADSL to increase penetration even to customers who do not use the Internet.

We introduced the new Alice autoinstallante, which can be installed without any technical assistance.

In October 2006, we provided our customers with a free automatic upgrade for Alice Flat accesses from 640Kbps to 2 Mb.

**Internet and VoIP Alice business.** We promoted VoIP with entry level ADSL to increase penetration and target customers who do not use the Internet yet.

In September 2006, we launched Alice Business 20 Mega, the Business rate plan based on ADSL 2+ technology.

We launched promotions associated with Alice Business Flat and 5 FAST, with no subscription charges for the first 2 months, Alice Business Sicura with a basic subscription charge of 1/month for the first 6 months, and HDSL in Liberty with no basic subscription charge for the first month on 2-Mb broadband access service.

A new Video service (CCTV Closed Circuit Television) rate plan is currently being developed.

**IPTV.** Coverage of the Alice Home TV (IPTV) service was extended to more than 250 Italian towns to enlarge the potential customer base. We also renewed the promotion, offering free installation by a Telecom Italia technical expert. At the end of 2006, we had 31,000 customers.

New agreements signed in 2006 expanded the portfolio of basic and premium content offered to Alice home TV users. At the end of 2006, Alice home TV programs were being broadcast on 24 channels. The annual movie catalog includes about 2,500 of the

most famous Italian and international movies, of which 500 are available each month on demand, with a monthly update of approximately 200 new titles of movies and TV series.

The commercial offering was enhanced by the upgrade of the access speed to 20 Megabytes and the launch of the new triple-play Alice Tutto Incluso rate plans. The promotion providing the customer with free installation by a Telecom Italia technician was also renewed.

**Public Telephone Services.** In 2006 there was the launch of the Mi chiami? service, which enables customers to receive calls from fixed and mobile networks on public phones.

**Alice portal** was mainly geared at:

- strengthening the editorial side of the portal by constant monitoring of the content being broadcast and supplying updates in real time on events of topical importance;
- implementing services using the web 2.0 logic to encourage customers to participate actively in the life of the portal and the creation of content. In this context, the new sections entitled Segnalo and Ok notizie were published and the new Alice video channel was released.

As a result of these actions in 2006, the Alice Portal confirmed its leadership position in Italy among the portals in terms of audience (about 2.3 million single visitors on an average weekday *Source: Nielsen/Netratings Sitelensus*) and Virgilio Advertising consolidated its leadership in Italy among advertising concession holders in the field of Internet Display Advertising (in 2006 advertising revenues with third-party customers amounted to 23 million, an increase of 36% compared to 2005).

- **Data Business**

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

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

VAS relating to data are principally represented by web-based, outsourcing and security services.

**Data business Lambda.** There was a significant repositioning of the price of the Lambda Wave service with regard to Long Distance and Metro. New POPs (Point of Presence) were activated to access the service, making it possible to extend the coverage of the new services in cities and over long-distance by more than 30%.

**Data business Hyperway, Datawan and Alice Business.** Access technologies were extended for both private Hyperway networks and for Internet access (Alice Business) by standardizing the fiber access solutions via Lambda with speeds ranging from 622 Mbps to 2.5 Gbps; with the launch of the new ADSL2+ profile speeds up to 20 Mega, with greater speed also upstream and different values of guaranteed bandwidth.

We launched the first integrated service between broadband IP Fixed/Mobile networks. The new service provides secure access to private MPLS Hyperway networks from mobile handsets through TIM's dedicated APN (Access Point Note) service.

**Telephone VAS Service.** We launched the Alice Basic rate plan which provides free registration to e-mail, community and other services offered by the Alice portal. We introduced the Tutto 4\* offer free for 3 months on all new installations and renewed the promotion in conjunction with Aladino and Videotelefono products. And for Business customers, we offered the Tutto 4\* package and the NT1 Plus socket free for 3 months upon purchasing the Aladino.

- **Wholesale**

The Wholesale offering includes national and international services for other operators, both for fixed and mobile operators and Internet service providers. Services offered to other domestic operators consist mainly of interconnection to the Telecom Italia network, in terms of access and traffic (collection, termination and transit), broadband access (ADSL and XDSL) and leased lines. Services offered to international OLOs Other Licensed Operators consist mainly of traffic (carried traffic and transits) and data accesses.

**National Wholesale**

In 2006, the national wholesale market clearly confirmed the trend for the service model whereby other operators acquire customers and keep them tied directly to their networks. All the main fixed network OLOs expanded their presence at Telecom



Italia exchanges and, at the year end, 1,071 exchanges had an average of 3 operators per exchange, and hosted systems which were already operational. The main consequence of these decisions by the OLOs is clearly evidenced by the trends of the two services: the increase in unbundling lines, to which there is a partial and corresponding contraction in Carrier Preselection lines, and the reduction in traffic collected through interconnection which, compared to 2005, fell by approximately 17%.

The following figures show the main types of customers of the OLOs:

**Local Loop Unbundling (LLU).** As of December 31, 2006, approximately 1,705,000 lines were connected directly to the networks of other operators, with an increase of approximately 590,000 lines, equal to 53%, compared to December 31, 2005. Similarly, as of December 31, 2006, shared access lines, with which other operators provide ADSL access to Telecom Italia's telephone customers, were approximately 329,000, with an increase of approximately 190,000 lines compared to December 31, 2005.

**Broadband Access.** As of December 31, 2006, XDSL wholesale accesses acquired by other operators were approximately 1,130,000, with an increase of approximately 240,000 compared to December 31, 2005.

**Carrier-PreSelection CPS Lines.** At December 31, 2006 the number of accesses configured totaled approximately 3,830,000, a decrease of approximately 255,000 compared to December 31, 2005, as a result of the migration to LLU.

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**Voice.** In 2006, initiatives designed to support the growth and profitability of Voice traffic continued to be implemented. As a result, despite competitive pressures with regard to incoming and outgoing traffic, international transit traffic reported a growth in volumes equal to 524 million minutes (+8.7% compared to the prior year). This result was mainly due to the acquisition of other wholesale customers (112 new interconnections, of which 60% in Voice Over IP) and the consolidation of privileged commercial relations with traffic aggregators and with customers/suppliers in Africa, the Middle East and Eastern Europe.

In 2006, the amount of outgoing international traffic decreased by 11.0% compared to 2005. Outgoing international traffic is mainly concentrated in the following traffic areas and represents about 41% of the total number of minutes in 2006: Romania, Germany, Switzerland, France, the United Kingdom, the United States, Ukraine and Albania.

Incoming international traffic may be subdivided into two categories: incoming traffic towards fixed networks and incoming traffic towards mobile networks. In 2006, incoming traffic towards fixed networks increased by approximately 159 million minutes (+7.8%) compared to 2005, while international traffic towards mobile networks reported a decrease of approximately 225 million minutes (-15.7%).

Attempts to safeguard profit margins were made by:

- increasing use of VoIP technology (2.5 billion minutes, +67% compared to the prior year) with a consequent reduction in unit costs;
- altering the mix of traffic by favoring destinations with higher unit margins (i.e. 20 new interconnections with mobile operators out of a total of 50 at the end of 2006).

The table below shows incoming and outgoing international traffic for the periods indicated (including direct dial and operator assisted calls and mobile traffic).

|  | <u>2006</u> | <u>2005</u> |
|--|-------------|-------------|
| Outgoing traffic (millions of minutes)                 | 3,717       | 4,176       |
| • <i>Percentage change in outgoing traffic (%)</i> (1) | (11.0)      | 4.7         |
| Incoming traffic (millions of minutes)                 | 3,414       | 3,480       |
| • <i>Percentage change in incoming traffic (%)</i> (1) | (1.9)       | 1.0         |
| Traffic in transit (millions of minutes)               | 6,575       | 6,051       |
| • Percent growth in traffic in transit (%)             | 8.7         | 11.0        |

—

(1) Percentage of growth in traffic compared to the prior year.

**Data/IP.** In 2006, the Data/IP market again reported substantial growth of bandwidth sold compared to 2005: an increase of 62.4 Gbps of IP bandwidth (or 71.4%), and an increase of 273.7 Gbps of managed bandwidth (or 68.4%).

This phenomenon offset the trend of lower prices, allowing an increase in revenues generated by innovative wholesale services of approximately 18% compared to 2005.

- ***European Broadband Project***

In 2003, Telecom Italia began its International Broadband project, and has since created an offering of innovative access and Broadband services in France, Germany and The Netherlands through the subsidiaries Telecom Italia S.A.S., HanseNet GmbH and BBNed N.V..

**France.** In 2006, Telecom Italia S.A.S., a subsidiary of the holding company Liberty Surf Group S.A., extended its coverage of service to 184 new LLU sites (open to delivery; new ready for service (**RFS**) sites number 266) bringing the total number of sites ready for delivery to 415 at December 31, 2006. To support the increases in coverage of LLU areas and Broadband traffic during 2006, it proved necessary to extend the IP network by introducing 40 new POPs.

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**Business Units**

The main services achievements in 2006 were the following:

- increase in the VoIP platform;
- introduction of Business Voice services to the platform;
- IPTV (content provider for IPTV service (**TPS**) free bouquet);
- Alice Pro Micro Business;
- Broadband to Broadband services (**B2B**).

**Germany.** During 2006 HanseNet extended LLU coverage to 100 more exchange areas and launched its wholesale service (broadband+voice) with Telefónica and QSC (another telecom operator) in 948 areas.

As a result, at December 31, 2006, 594 sites were open to the LLU offering (an increase of 100 areas since December 31, 2005) whereas 948 sites were open to the wholesale offering.

During the year 2006, a due diligence was conducted with regard to the acquisition of the broadband and narrowband customer portfolio of AOL Germany. The transaction closed in February 28, 2007 following authorization received from the European regulatory authority.

The following were the main achievements in 2006:

- introduction of IP Digital Subscriber Line Access Multiplexer (**IPDSLAM**) and Coarse Waive Division Multiplexer (**CWDM**) to support the significant use of IPTV and VOD in the Hamburg area;
- introduction of the VoIP Italtel platform to manage wholesale customers;
- Vdsl2+ (a high-speed evolution of ADSL Service) trials at 4 sites in the Hamburg area;
- reorganization of the voice platform using an architecture which will manage customer growth in 2006 and in the following years in a more flexible way (separation of the level of access from the level of transit / interconnection with other networks).

**The Netherlands.** The Dutch market has reached the highest level of broadband penetration in the European Union (70%). Within the DSL market KPN through a series of ISP acquisitions (the most recent being that of Tiscali Netherlands last September), consolidated its dominant position, reaching a market share of 73%.

During 2006, the aggressive strategy on the part of KPN resulted in a contraction of about 10% of BBNed's customer base.

In an effort to counter this trend, in 2006, BBNed launched a Fiber offer for business customers (approximately 7,700 customers). The acquisition of the ISP InterNLNet is currently being assessed with the aim of extending the Fiber offering to the residential market.

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

|   | As of and for the year ended<br>December 31, |        |        |
|---|--|--------|--------|
|   | 2006   | 2005   | 2004   |
| <b>Statistical Data:</b>  |  |        |        |
| <b>Wireline:</b>  |  |        |        |
| Fixed network connections in Italy (thousands)(1)                                   | 23,698                                       | 25,049 | 25,957 |
| Physical accesses (Consumer + Business) (thousands)                                 | 20,540                                       | 21,725 | 22,395 |
| Voice pricing plans (thousands)(2)  | 6,468  | 6,321  | 5,883  |
| Broadband Accesses (thousands)(3):  | 8,660  | 7,020  | 4,430  |
| • Domestic (thousands)  | 6,770  | 5,707  | 4,010  |
| • European, other than domestic (thousands)   | 1,890  | 1,313  | 420    |
| Alice page views - ex-Virgilio (millions)   | 13,283                                       | 9,842  | 7,902  |
| Alice (ex-Virgilio) average monthly single visitors (millions)                      | 19.1   | 15.7   | 13.9   |
| Network infrastructure in Italy:  |  |        |        |
| • Access network in copper (millions of km pair)                                    | 105.7  | 105.2  | 105.2  |
| • Access network and transport in optical fibers (millions of km of optical fibers) | 3.7  | 3.7    | 3.7    |
| Network infrastructure outside Italy:   |  |        |        |
| • European backbone (km of optical fibers)  | 51,000                                       | 51,000 | 39,500 |

(1) Data exclude internal lines.

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

(3) Number of contracts.

As of December 31, 2006, the Wireline Business Unit had approximately 23.7 million fixed subscriber lines including approximately:

- 16.1 million residential lines (including ISDN equivalent channels);
- 7.5 million business lines (including ISDN equivalent channels); and
- 180,000 Public Telephones connections (including ISDN equivalent channels).

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As of December 31, 2006, the Wireline Business Unit had approximately 5.1 million ISDN equivalent lines. The continuing decline in the number of PSTN connections can be attributed to the gradual increase in ADSL lines, which provide greater speed on the Internet, as can be seen from the significant growth in broadband access.

### V TRAFFIC AND TARIFFS

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

|   | Year ended December 31, |              |              |
|---|-------------------------|--------------|--------------|
|   | 2006                    | 2005         | 2004         |
| Wireline total traffic (Retail and Wholesale) (billions of minutes) | 173.8                   | 185.1        | 192.0        |
| <i>of which:</i>  |                         |              |              |
| <i>Domestic(1)</i>  | <i>160.1</i>            | <i>171.3</i> | <i>179.1</i> |
| <i>International(2)</i>   | <i>13.7</i>             | <i>13.8</i>  | <i>12.9</i>  |

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

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

**Domestic Fees and Tariffs.** Since November 1, 1999, our traffic tariffs have been based on a per second billing system (TAT), with an initial fixed charge which varies depending on the type of call made (local, national, fixed-mobile, international) and a charge per second which, in addition to the type of call made, also varies

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according to the time of day and day of the week when the call is made. Since December 1997, we have introduced rate plans, aimed at the residential and business customers, which provide for discounts on national and international traffic against payment of an extra subscription charge.

Rate plans mainly consist of offers such as Teleconomy or Hello for the retail market and SOHO customers. Customized offers are provided to business customers.

For business customers, special offers have been introduced for companies with high volumes of traffic, allowing companies to choose from a wide range of rate plans.

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

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

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

- access;
- local and long distance calls; and
- 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 basket of public voice telephone services includes one-off fees, monthly fees, domestic and fixed to mobile standard tariffs.

In accordance with the Price Cap mechanism, during 2006, we introduced the following rate plan changes:

- an increase of 153.2 million in access charges for business customers which represents an increase of 8.5% for this segment of customers, even though this increase is only equivalent to 3.4% when viewed from the standpoint of the access segment as a whole (residential + business);
- a reduction in fixed-mobile rates with the consequent reduction of the amount retained of approximately 20.7 million (equal to a reduction of 4.1%).

The same price cap mechanism is applicable in 2007.

#### V INTERCONNECTION WITH OTHER OPERATORS

On March 22, 2003, the NRA approved the introduction of the Network Cap mechanism to regulate interconnection charges until the end of 2006. The mechanism regulates the amounts which operators must pay Telecom Italia if they use our network to offer their telecommunications services. Beginning with the 2003 Basic Offering ( **RO** ), the market has gained greater transparency with regard to interconnection services, allowing other operators to base their business plans on stable, pre-established economic values.

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With respect to LLU and with reference to Order (4/06/CONS) on market No. 11, on March 3, 2006 Telecom Italia published its new RO on Local Loop Unbundling (including shared access). We currently apply an LLU price of 8.05/a month, the lowest in Europe and significantly lower than the retail price of access. Regarding implementation, the Italian LLU market reported the fastest growth in Europe, with about 1,705,000 unbundled lines activated at December 31, 2006 (Italy is in second place after Germany where LLU was started about two years before), representing an increase of about 590,000 lines compared to December 31, 2005.

In addition, Telecom Italia has the most detailed and complete LLU offering in Europe (physical LLU, sub loop unbundling, shared access and different ways of collocation) and has satisfied all the NRA's requirements in terms of making available sites requested by other OLOs. During 2006, the OLOs increased their use of the shared access service and 329,000 lines were activated by the end of the year.

Since January 2005, we adopted a series of extraordinary and temporary measures for the two-year period 2005-2006 for broadband access, dedicated to transport and wholesale network infrastructure services with the aim of further promoting competition.

On July 3, 2006, the NRA approved the 2006 RO published by Telecom Italia on October 28, 2005. For LLU services, the approval was valid until March 2, 2006 as we published a new 2006 RO on March 3, 2006.

At December 31, 2006, the NRA had not yet approved our new 2006 RO.

The 2006 RO includes the conditions for the **FRIACO** (Flat-Rate Internet Access Call Origination) service, partial lines, shared access and subloop unbundling, fostering competitive growth of Internet access and broadband services:

- FRIACO: the service has been offered since 2001;
- Partial circuits: represent partial circuits from customer premises to the OLO's POP (Point Of Presence), as a segment of an end-to-end leased line;
- Billing and bad debt service: Telecom Italia must also offer billing services to OLOs who decide not to bill their customers (i.e. customers are connected to the network through indirect access service) accessing their toll-free numbers. Telecom Italia, as required by the NRA, fixed the charging level for the billing service at 2.9% calculated on the total revenues of each OLO's toll-free service. With respect to bad debt, the level of risk and insolvency is subject to negotiation between Telecom Italia and the OLOs. In Resolution No. 1/05/CIR, the Authority specified the need to create a special procedure for calculating the value of invoicing for non-geographical services. Since the NRA has not created such a procedure, despite numerous demands on the part of Telecom Italia, following the expiry of the administrative terms for the creation of the above-mentioned procedure, Telecom Italia announced that, for the year 2006, the value of the invoicing service will be fixed at 9.1%, a figure taken from the results of the Regulatory Accounts for fiscal year 2004.

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In 2006, Telecom Italia presented its separate Regulatory Accounts for fiscal year 2005.

In compliance with Recommendation No. 2003/497 and with the Electronic Communications Code (Legislative Decree 259 dated August 1, 2003), on May 19, 2004, the NRA started public consultations with regard to the 18 significant markets identified in the Recommendation and in articles 18 and 19 of the Code. These market analyses were completed during the course of 2006.

In 2006, we signed or renewed the following contracts with operators:

- 3 interconnection agreements;
- 4 supplementary reverse agreements, termination on the network of another operator;
- 17 agreements to supply high speed access through xDSL technology;
- 3 carrier preselection contracts and 5 number portability contracts;
- 4 contracts for the shared access service on the local network and 5 LLU contracts;
- 7 contracts to supply Digital Data Circuits or partial circuits;
- 5 agreements for fiber optic infrastructures.

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The sales structure of Telecom Italia is organized according to a vertical, multi-channel approach, in which different types of channels are specialized in different customer segments of the market. This approach rewards the focus and customization of the channel-offering-market mapping.

The top 20,000 customers benefit from direct supervision with almost 500 sales accounts, each one of which has a dedicated portfolio to supervise and develop over the whole range of the offering: fixed, mobile, telephone, data, ICT services and products.

All other customers (both business and consumer) are managed by indirect commercial channels, with a total of approximately 300 partners (external sales firms working for Telecom Italia), employing 2,400 commercial staff and 5,000 telephone operators, handling approximately 2,000,000 contracts a year. Selling techniques range from sale through physical consultancy to sales by phone through the outbound network.

The main channels are:

- the Telesales channel: an Outbound network of about 40 partners with more than 4,000 operators who are assisted by about 200 internal resources, which focuses on volume acquisitions (for example, pricing offers, ADSL);
- the Agent Sale channel: a territorial network of about 35 partners and 800 agents (commercial staff), which focuses on volumes, and is directed towards the Consumer market supervised according to a list and door to door supervision;
- the ET Export Team channel: a territorial network of 6 partners with approximately 500 agents and 500 employees that sale by telephone, which focuses on the development of the SOHO segment through offers with regard to pricing, ADSL and products, geared mainly to commercial businesses, small professional firms and SOHO;
- the BP Business Partner channel: a network of about 110 partners and 800 agents organized geographically, which focuses on supervising SME (Small and Medium-size companies), the development of broadband, and the sale of products;
- the VAR Value Added Reseller channel: a territorial network with about 65 partners and 180 Commercial Staff, which focuses on the development of VAS, the customized offering and complex networks;
- the Public Telephone channel: a network of about 40 partners focusing on national and international prepaid card services and associated traffic packages.

In addition to these partners, there is the pull channel, consisting of the retail network of shops, dealers, and organized and specialized large-scale distribution, amounting to a total of about 5,000 retail points of sale.

V **FIXED NETWORK**

***Domestic Network***

**General.** Our domestic fixed network consists of 33 gateway areas (each gateway area has two interconnection points which enable information to be exchanged between the fixed and mobile networks) 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 2,300 VC4 (equivalent to 188,000 2-Mbps circuits), 56 2.5-Gbps point-to-point lambdas and 36 10-Gbps point-to-point lambdas for a further 3,200 VC4 equivalents (whose effective transported band is equal to approximately 120 Gbps). The fixed distribution network includes 105.7 million km of copper pairs.

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At December 31, 2006, the domestic fixed network consisted of the following:

|  |   |
|--|---|
| Exchange areas                             | about 10,400                                    |
| Switching areas                            | 628 Urban Group Stages (SGU)                    |
| Gateway areas                              | 33  |
| Copper access network                      | 105.7 million kilometers-pair                   |
| Fiber optic access network                 | 430,000 kilometers-line                         |
| Fiber optic carrier network                | 3.24 million kilometers-line                    |
| Long Distance VC4                          | 2,300   |
| Long Distance Lambda                       | 56 2.5 Gbps, 36 at 10 Gbps                      |
| Network for direct digital circuits (PARD) | 339,000 access points with speed up to 2 Mbit/s |
| Network for direct analog circuits (PARD)  | 86,000 access points                            |
| Frame Relay Accesses                       | 85,000 gates at 2Mbit/s                         |
| POP main data networks                     | 32  |

**SDH and ATM.** We introduced SDH transmission technology into operation in the long distance fixed network in 1996 and introduced such technology into operation for our local fixed network during 1997. These transmission systems are operating on fiber optics 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 2006. In order to reduce the number of fibers used, DWDM systems have been used to multiply by a factor of 12 up to 40 the available optical fiber band and the current transmission capacity, thus increasing the transport capacity of the connections. In November 2002 Wireline introduced a new generation of Optical Digital Cross Connect on the domestic wireline transmission backbone in order to progress with the transition from a national network based on a SDH rings architecture, towards the new generation of meshed ASTN (Automatically Switched Transport Network) optical backbone which started in 2003, continued during 2005 connecting over 31 cities (all the major cities of Italy) and continued 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 a completely optical network will make it possible to increase the operating capacity for all types of traffic, from voice to Internet.

ATM switching technology, introduced in 1996, allows the transfer of information combining data, video, voice and other services on public and private networks both at a national and international level. Telecom Italia's ATM/Frame Relay 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 allow customers to access IP and MPLS services (Multi Protocol Label Switching) with access speeds of between 64 kbit/s to 155 Mbit/s.

**OPB (Optical Packet Backbone).** In 2006 the first phase of the construction of the OPB network was completed. This network will be used for Internet traffic of residential customers and for VPN (Virtual Private Networks) for business customers.

**OPM (Optical Packet Metro).** An OPM was installed in 2006 in 30 metropolitan areas to collect flows to and from residential customers through DSLAM IP to supply the IPTV service. The OPB network is also used for backhauling UMTS through the GBE (Gigabit Ethernet) concession, a first generation ROF (Radio Over Fiber).

**Gigabit Ethernet Access.** Work continued on construction of the network to support the marketing of services based on Gigabit Ethernet technology (the Ethernity, Hyperway and Genius services on GBE optical access). 390 new GBE access points were installed, bringing the overall number to approximately 2,070 accesses. In 2006, coverage of services with GBE optical access was extended to the towns of Cuneo and Novara. As a result, overall coverage increased from 24 to 26 towns in Italy.

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**Network quality and Productivity.** In 2006, porting of all the OSS systems on OPEN platforms was completed, thus reducing running costs. In addition, the work of integrating the systems which supervise the fixed and mobile network began. The platforms for creating services are being reviewed and are scheduled for completion in 2007. In 2006, work began to extend the QoS control systems to embrace end to end monitoring. These systems are already active for the mobile network and are being extended for the fixed network.

**Broadband/ADSL network.** Telecom Italia's broadband network can offer hi-tech telecommunications services and multimedia applications. This objective is being reached through the gradual installation of fiber optic cables. In 2006, the commercial services offering access to ADSL for residential customers, business customers and Internet Service Providers were extended to 4,650 towns (compared to 3,800 at the end of 2005). Commercial services for the business sector include using ADSL in urban areas to access the IP and ATM services supplied by data networks. Services for ISP include the supply of ATM accesses with ADSL access to the public, leaving the ISP to handle relations with the customer. At the end of 2006, 5,630 local switching areas were covered by ADSL technology, (compared to 4,500 at the end of 2005).

**Fiber optic cables.** At December 31, 2006 approximately 3.7 million kilometers of fiber optic cables have been installed for access and transport, of which approximately 1.2 million kilometers are installed in the long-distance network. Fiber optic cables significantly increase network capacity and make it possible to offer hi-tech services based on the simultaneous transmission of various types of signal, such as voice, data and video. To make these services more widely available, introducing fiber optics to the access network is being considered.

**VoIP (Voice over IP) Services.** The complete digitalization of the network both the backbone and the metropolitan network is proceeding towards the distribution network (with ADSL), thus favoring the introduction of VoIP and other associated services. These services are already available to the business customers and the residential customers who sign up for ADSL. VoIP is regarded as an additional service, the value of which, for the customer, is expressed in having access to a greater number of lines, numbers and terminals. Furthermore, by exploiting extra functions, such as the presence and communities typical of always-on connection systems, it is possible to have additional revenues. At the same time, the value added perceived by customers contributes to the expansion of broadband and, consequently, increases the benefits resulting from complete digitalization.

**IPTV (Internet Protocol TV).** Quadruple play is regarded as having significant value since customers find themselves immersed in an environment that can be exploited on several levels and which is able to supply a vast range of services. IPTV is an important part of this evolution. Tests were conducted in 2004-2005 and, in 2006, the first commercial service was launched. At the end of 2006, the commercial service with access to IP TV technology was extended to 258 towns (836 exchange areas). IPTV is seen as one of the pieces in the overall jig-saw which hopes to give each customer the chance to access information in any form, wherever they are, and using the fixed or mobile networks according to the situation.

**Flexible Data Networks.** An important part of the network consists of dedicated data lines which are centrally controlled from a single workstation. At the end of December 2006, there were approximately 339,000 PARD CDN (Data Network Access Points with Direct Digital Circuits) and approximately 86,000 PARD CDA (Direct Analog Circuits).

**International Network**



The Telecom Italia Sparkle network is a fully integrated cross-border backbone, located mainly in Europe, the Mediterranean, the U.S.A. and Latin America. Construction of the backbone began in 1997.

Through Telecom Italia Sparkle we offer international wholesale services (Voice, Data and IP) and retail Global Corporate Network services for multinational customers using its cross-border backbone, bilateral connections and NNIA (Network to Network Interconnection Agreements).

The cross-border backbone integrates 3 regional networks in Europe (**PEB**), Latin America (**LAN**) and in the Mediterranean basin (**MED**):

- **PEB** (Pan European Backbone). Proprietary fiber optic network 2 fiber pairs, each with 400 Gbit/s which extends into Europe's leading industrialized countries: Italy, France, the U.K., The Netherlands,

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**Business Units**

Belgium, Germany, Switzerland, Austria and Spain, with a total length of 12,000 km. In 2006, the PEB network was integrated with the network acquired from Tiscali International Network S.A.S. so that it now also stretches into the Czech Republic, Poland and Slovakia. The overall length of the entire backbone is 23,500 km. The cross-border services available to wholesale customers are: Managed Bandwidth, IP Connectivity, International Private Leased Circuits (IPLC), Voice services and GRX (GPRS Roaming eXchange for Mobile Operators). The main services available for MNC (Multi National Corporate) customers are: IP/MPLS (Internet Protocol/Multi Protocol Label Switching), Managed Bandwidth and Voice services.

- **LAN** (Latin American Nautilus). A high-capacity backbone based on an optical fiber ring network, both land-based and under the sea, with a total length of 30,000 km, including the Miami-New York section. The ring, which has automatic optical traffic protection and a capacity of up to 320 Gbit/s, connects the main cities of South America to Central and North America.
- **MED** (Mediterranean Nautilus). A submarine optical ring, with a highly reliable configuration, and a total length of 7,000 km 6 fiber pairs, 64 lambdas (each one of 10 Gbit/s) per pair of fibers which connects the main markets of the Mediterranean area: Italy, Greece, Cyprus, Turkey and Israel. Currently, the main landing points are Catania, Athens, Chania-Crete, Haifa and Tel Aviv.

The International Network connects more than 400 operators worldwide and extends for more than 434,500 kilometers along submarine cables that, from Italy, transport traffic along two major paths: East/West routes (towards the United States, Middle and Far East) and North/South routes (toward Central and Northern Europe) the Mediterranean, split into longitudinal (towards the United States, the Middle East and the Far East) and transversal traffic routers (towards Central Europe and Northern Europe).

The Backbone was created to provide end-to-end services in strategic areas for Telecom Italia Sparkle: it has Points of Presence (POP) in Europe (24 POP), the U.S.A. (6 POP), the Mediterranean (5 POP), South America (9 POP) and Asia (1 POP).

The POP in the United States belong to Telecom Italia Sparkle of North America ( TISNA ), a company entirely controlled by Telecom Italia Sparkle, which has created POPs in Newark (NJ), New York (NY), Miami (FL), Ashburn (VA), Chicago (IL) and Palo Alto (CAL) to support the offering of IP/Data and Voice services with a network connected to the European Backbone and the Backbone in Latin America, Latin American Nautilus.

The services supplied include telephone, IP and Managed Bandwidth services in Europe and in the U.S.A., and Managed Bandwidth and IP services in the Mediterranean and in South America.

The platform for services to MNC (Multinational Corporate Clients) is integrated with the cross-border network.

During 2006, the major international network projects related to:

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- the complete integration of the European network of Tiscali International Network SAS (TINet S.a.s.), acquired at the end of 2005, with the Pan European Backbone;
- new IP POPs in Chicago and Palo Alto, of the subsidiary TISNA, with the aim of increase direct interconnections with U.S.A. Tier 1 locations and content providers; and
- expansion of capacity and development of new functions for the transmission network (creation of meshed architecture).

With the acquisition of TINet's European network, a network, of approximately 11,500 kilometers, our network extended its coverage to Eastern Europe and includes diversified fibers made by different suppliers on all the main sections. In addition, interconnection of the two networks in Milan, Marseilles and Paris was completed, migration of the running and control functions at the NOC (Network Operation Center) of Telecom Italia Sparkle was completed and the management software for implementing a meshed architecture was updated (at least three separate fiber routes on all the main POP with automatic circuit rerouting).

Telecom Italia Sparkle is one of the first European operators to implement this kind of architecture on its transmission network.

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To support the increase in Internet traffic, efforts were made to expand the backbone in Europe, the U.S.A. (new POPs were opened in Chicago and Palo Alto and a proprietary 10-Gbt/s backbone was built between the previous junctions and Newark, Miami and Ashburn) and the network's trans-Atlantic capacity. Meanwhile, in Italy, the construction of a second POP was completed in Milan with the aim of increasing the reliability of the IP backbone.

In 2006, significant extensions were made to the POP of Palermo, the landing points in Italy of the new South East Asia-Middle East-Western Europe 4 ( SEA-ME-WE 4 ) submarine cable system, activated at the end of 2005.

The system links 15 countries including Singapore, Malaysia, Thailand, Bangladesh, India, Sri Lanka, Pakistan, the United Arab Emirates, Saudi Arabia, Egypt, Italy, Tunisia, Algeria and France.

Palermo has become one of the main interconnection junctions between Western Europe and Asia, allowing Telecom Italia Sparkle to meet the demand for greater capacity and services from areas of the world with the fastest-growing economies.

In 2006, the NGN (Next Generation Network) platform was developed further. This has made it possible to implement the IMS (IP Multimedia Subsystem) architecture. With the NGN platform, which currently manages more than 300,000 circuits with more than 400 operators, Telecom Italia Sparkle has become the first European carrier to use the IP protocol for its whole international telephone network.

**4.2.3 DOMESTIC MOBILE**

The Domestic Mobile Business Unit operates through the mobile segment of the Company. On March 1, 2006, Tim Italia, the operator of the domestic mobile business was merged with Telecom Italia.

As of December 31, 2006, the Business Unit was organized as follows:

**Domestic Mobile**

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Telecom Italia Domestic Mobile Segment

**v KEY FACTORS**

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- During 2006, the Domestic Mobile Business Unit focused on regaining and stabilizing its market share, which, in recent years, had been eroded by increasing competition from other operators, and on increasing the penetration of UMTS users within its customer base (in 2006, UMTS customers were approximately 4.2 million, almost double the number of customers in December 2005). This strategy enabled the Business Unit to achieve growth in revenues, despite strong pressure from competition and new regulations (in 2006 termination fees were significantly reduced).
- In order to strengthen its competitive position on the Italian market, the Domestic Mobile Business Unit adopted a segmented business strategy, approaching specific customer segments (for example the Elite and Young segments) with dedicated offers in areas where in recent years, the Business Unit had assumed a weaker position. New rate plans were introduced in the Business segment to stimulate on-net traffic and new flat packages were offered which included voice, messaging and hi-speed data services.
- With respect to technological innovation, the Domestic Mobile Business Unit introduced DVBH (Digital Video Broadcasting Handheld) technology (which activates TV services on mobile handsets) and HSDPA technology, an evolution of UMTS technology, which allows connection speeds of up to 3.6 Mbps. By the end of 2006, DVB-H had reached about 72% of the population, whereas penetration of HSDPA exceeded 32%. This should further stimulate the use of value added services, especially interactive services (for example Browsing), which, in 2006 increased by more than 20%.

### V GENERAL INFORMATION ON SERVICES IN ITALY

Domestic Mobile offers a GSM digital service, which commenced operations in April 1995, and 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

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other countries. Beginning in 2005, Domestic Mobile offered its whole third generation services (based on UMTS technology) and the advanced second generation services through the EDGE technology. These technologies are interoperable and permit seamless usage of dual mode handsets linked to UMTS and GSM/EDGE networks. At December 31, 2006, we had 456 active roaming agreements with 196 countries (an increase of 10 new agreements and 3 new countries compared to December 31, 2005) allowing our customers to make and receive calls abroad. In particular, there were 186 GPRS agreements in 102 countries (an increase of 22 agreements and 10 new countries compared to December 31, 2005), 47 3G agreements in 32 countries (with an increase of 18 agreements in 8 countries), 120 customized application mobile enhanced agreements or Camel agreements, which allow international roaming for prepaid mobile services in 89 countries (an increase of 16 agreements in 12 countries compared to December 31, 2005).

In 2006, Telecom Italia elected to comply with the code of self-regulation with regard to international roaming charges. This code involves the introduction of an average wholesale charge of 0.45 for calls made within the EU. In addition, to compensate for the negative impact on revenues of the code of self-regulation and to support international wholesale revenues, charges were reviewed, leading to an increase in charges for both SMS and calls made outside the EU.

As a result, 60 Inter-Operator Tariff discount agreements were signed (valid in 100 countries) to reduce the costs of TIM Roamers abroad.

In May 2007, the EU Parliament approved a regulation which, starting summer 2007, will substantially reduce the charges for using mobile phone abroad.

**V CUSTOMERS AND LINES**

The penetration of mobile telecommunications service in Italy is above the Western European average at approximately 139 lines per 100 inhabitants at the end of 2006 compared to a penetration rate of 123.5 lines per 100 inhabitants at the end of 2005. Growth rates have been substantially higher than the European average. The increase is due to innovative services and an increase in customers with multiple lines and the number of operators. The customer base consists of GSM subscribers and customers holding GSM/UMTS TIM Cards ( **GSM/UMTS Prepaid Customers** ).

At December 31, 2006 the number of GSM and UMTS mobile lines operated by Telecom Italia amount to approximately 32.4 million (of which 4.2 million are UMTS lines) with a growth of 13.6% compared to December 31, 2005. This figure includes 4.3 million GSM subscribers and 28.1 million prepaid lines, which make up 86.5% of total lines. The TACS service was closed down at December 31, 2005.

The continuous growth of lines shown in the table is mainly due to growth in UMTS services and the gradual availability of third-generation handsets.

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At December 31, 2006 Telecom Italia's market share calculated on number of lines was at 40.4% compared to 40.0% at December 31, 2005. In particular, in 2006, Telecom Italia had a market share of 43% in terms of the net additions in GSM and UMTS lines, corresponding to about 3.9 million lines.

The number of lines counted by Telecom Italia does not include about 735,000 inactive lines.

Average monthly revenues per line (which include total revenues from fees, traffic (domestic and international) and VAS, excluding revenues from the sale of products) declined from about 29.3 in 2005 to about 25.6 in 2006 (including revenues from services for non-TIM customers).

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The table below sets forth, for the periods indicated, selected customer data for our Domestic Mobile Business Unit.

|  | As of and for the year ended<br>December 31, |        |        |
|--|--|--------|--------|
|  | 2006   | 2005   | 2004   |
|  | (number of customers<br>in thousands)        |        |        |
| Mobile telephone lines in Italy at year-end(1) | 32,450                                       | 28,576 | 26,259 |
| GSM subscriber lines                           | 4,370  | 3,186  | 2,809  |
| Prepaid GSM/UMTS Lines                         | 28,080                                       | 25,296 | 23,226 |
|  | (in %)                                       |        |        |
| Customer growth                                | 13.6   | 8.8    | 0.7    |
| Churn rate(2)                                  | 16.4   | 16.9   | 13.2   |
|  | (in Euro)                                    |        |        |
| Average monthly revenues per line(3)           | 25.6   | 29.3   | 29.9   |

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

(2) The figures refer to the total number of lines. The churn rate for a given period represents the number of mobile customers who ceased to be customers during the period (by choice or due to unpaid bills) expressed as a percentage of the average number calculated on the basis of the annual numbers of customers during the period.

(3) Includes total revenues from fees, traffic (domestic and not) and VAS, excluding revenues from the sale of products.

**V TRAFFIC**

In 2006, traffic volumes increased by 5.1% in terms of minutes, although revenues from voice services, net of the impact of new termination list prices, only increased by 3.0% compared to the prior year.

The table below sets forth, for the periods indicated, selected traffic data for our Domestic Mobile Business Unit.

| Year ended December 31, |      |      |
|-------------------------|------|------|
| 2006                    | 2005 | 2004 |
| (millions of minutes)   |      |      |



|   |          |          |          |
|---|----------|----------|----------|
| Total outgoing traffic per month              | 2,443    | 2,314    | 2,211    |
| Total incoming and outgoing traffic per month | 3,730(1) | 3,550(2) | 3,435(3) |

- (1) Includes domestic mobile incoming and outgoing traffic (92.8% of total mobile traffic), international traffic (2.2%) and roaming traffic (5.0%). Data includes fixed outgoing traffic to the mobile network.
- (2) Includes domestic mobile incoming and outgoing traffic (92.2% of total mobile traffic), international traffic (2.6%) and roaming traffic (5.2%). Data includes fixed outgoing traffic to the mobile network.
- (3) Includes domestic mobile incoming and outgoing traffic (93.8% of total mobile traffic), international traffic (2.2%) and roaming traffic (4.0%). Data includes fixed outgoing traffic to the mobile network.

#### V MOBILE TARIFFS

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

Domestic 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/UMTS TIM Card 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 (it should be noted that recharging fees were abolished with the introduction, on March 5, 2007, of the so-called *Bersani Decree* ). No other connection or

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subscription fees or taxes are payable by Prepaid Customers. Mobile customers (including Prepaid Customers) must purchase their own mobile telephone handsets. In 2006, approximately 64% of Domestic Mobile revenues services were derived from traffic charges (net of access charge), 8% from sales and rental of equipment, 17% from VAS and 11% were miscellaneous revenues (subscriptions and connection fees, including recharge fees).

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

In 2006, innovative mobile telephone services were developed with the aim of increasing customer loyalty and higher usage of mobile phones. The main initiatives were:

- **TIM Tribù** . Launch of the TIM Tribù service dedicated to the young segment of the customers. The new rate plan aims to attain a competitive positioning by targeting young people, to educate and encourage them to favor the use of VAS services, and expand the TIM community. This rate plan offers advantageous charges for calling and sending SMSs within the TIM tribù community. TIM Tribù is not only a rate plan but also a range of exclusive services for young people. They include the TIM Tribù TAM TAM Push to Talk service, through which all TIM Tribù customers can send voice messages free within the TIM Tribù community. In May 2006 Ricarica Alice Ricarica TIM Tribù was launched with a view to integrating the fixed-mobile offering. As a result, for 10, a TIM Tribù customer receives 20 of traffic, of which 8 is for surfing the Internet with Alice ADSL and 12 for making calls to friends in the TIM Tribù community. In October 2006 we launched a the new TIM Tribù rate plan which eliminates top-up charges and is the first rate plan which enables customers to be reimbursed for the cost of the top-up, for top-ups of any amount and any channel, by awarding a bonus of voice and SMS credit to spend within the Tribù community.
- **TIM Famiglia**. The TIM Famiglia package for prepaid users was launched at the end of 2005, and the version for subscribers followed in February 2006. The rate plan for prepaid users involves reduced charges for calls and video calls to 3 numbers (2 TIM numbers and 1 fixed-network number) at 1 eurocent per minute and an automatic top-up for all calls received from all numbers on the fixed network.
- **Relax**. This is the new portfolio of Relax rate plans for prepaid users and subscribers. The offer involves a UMTS handset at a special price, which can be paid for in installments, phone services, SMS and a VAS component. The aim of the rate plan is to attract customers with a high propensity for consumption by guaranteeing flat rates and advantageous conditions. Telefono Relax, which is directed at the mass market, and emphasizes the appeal of the telephone, will help to augment customer loyalty, and will have a positive effect on the ARPU.

To speed up the process of acquiring and locking-in quality customers, in October 2006, two new features were added to the Relax range, Relax 15 and Relax 40, and new promotions are being introduced to the already existing rate plans.

- **TIM Welcome Home**. Launch of the TIM Welcome Home rate plan for the ethnic international segment for prepaid customers. This plan offers lower charges for international calls to some ethnic countries, together with a charge of 6 eurocents per minute for domestic calls made within the TIM Welcome Home community. On August 9, 2006, the launch

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of TIM Welcome Home top-ups for customers who signed up for the new TIM Welcome Home profile. Since October 2006, the TIM Welcome Home top-up (physical top-up) has been available at all the TIM POS.

- **7 su 7 no tax.** Launch in October 2006 of the 7 su 7 no tax rate plan, designed for professionals and small companies and a new feature of the 7 su 7 product range. The main feature of this service is the elimination of the Government Tax Concession of 12.91 per month (excluding VAT). Against a monthly payment of 7 (excluding VAT), 7 su 7 no tax allows customers to call any numbers on the fixed and mobile networks from Monday to Friday at the cost of 7 eurocents per minute (excluding VAT), plus a connection charge of 15 eurocents. During weekends, all calls are free for the first 5 minutes of each single call (after which the charge is 7 eurocents per minute). For all calls to

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numbers included within the same contract, only the connection charge of 15 eurocents (excluding VAT) applies, including the first 15 minutes of the call (after which the call is charged at 7 eurocents per minute).

- **7 su 7 no cost.** This new rate plan, launched in October 2006, enhances the 7 su 7 no tax rate plan. Both have the same charges but, in the case of 7 su 7 no cost, the monthly subscription charge of 7 (excluding VAT) is waived for the first 12 months of the subscription. The offer also gives customers the chance of choosing from a vast range of UMTS telephones.
- **7 su 7 night and day.** This rate plan is also an extension of the 7 su 7 range. By paying a rental charge of 19 per month (excluding VAT), customers can call any number on the domestic fixed or mobile network between 9 p.m. and 7 a.m., paying only the connection charge of 15 eurocents (excluding VAT), including the first 5 minutes of the call. After that, there is a charge of 7 eurocents per minute.

But all calls made between 7 a.m. and 9 p.m. are free (only the connection charge of 15 eurocents is applied) until the customer has clocked up 6 hours per month of conversation for the first 3 months of subscription. After that, there is a ceiling of 3 hours per month of conversation. If traffic exceeds the established ceiling, the standard charge of 7 eurocents per minute (excluding VAT) is applied.

- **Messaging rate plans.** In the summer 2006 we launched the promotion Carta Vacanze Messaggi Relax, from May 29 until August 6, 2006. Against payment of 5, customers could obtain a special rate for SMS (5 eurocents) and MMS (30 eurocents) up to a maximum of 1,000 messages for 30 days to all mobile and fixed numbers. In September, the TIM ScriviScrivi service was launched. From September 12, 2006 until October 21, 2006, customers could send 500 SMS or MMS messages free to TIM and Telecom Italia numbers and all e-mail addresses, against payment of an activation cost of 9.

The 1x100 di TIM rate plan launched on February 5, 2006 offers a bundle of 100 SMS, 100 MMS and 100 video minutes. Each day, after the first text or the first minute of a paid video call, customers receive a bundle of free traffic which they can use to send texts or video call any TIM customer within 30 days.

In November 2006, Domestic Mobile launched Alice Messenger, the new Instant Messaging service offered to all Alice and TIM customers, which can be accessed either from fixed or mobile systems, and which allows users to communicate in real time using PC to PC, PC to mobile, mobile to PC or mobile to mobile. For the time being, the service is available from a mobile to 8 legacy terminals and 11 new terminals which have just become available on the market. After the launch, further developments are planned to extend the number of compatible terminals and make the service available to other devices.

From a PC it is possible to send or receive text messages fixed and mobile systems, originate and receive audio and video calls (through the username@alice.it) other Alice customers from a PC, and create your own list of friends by pulling contacts directly from the centralized address book of the Internet.

From a mobile it is possible to exchange text messages with other TIM and Alice customers. Access to the seamless service is based on a mobile telephone number.

- **Availability of services.** Since August 2006, all TIM customers have been able to use the automatic recall service with Telecom Italia fixed numbers. The ChiamaOra di TIM service for fixed line Telecom Italia numbers enables TIM customers to book a recall even if the fixed number being called is engaged. A TIM customer can either activate the recall option or select the option to receive an SMS alert as soon as the fixed number being called becomes free. This service is free and is automatically activated for all TIM customers.
- **Mobile Number Portability (MNP).** In February 2006 we launched a new MNP rate plan with a bonus of 250 of free traffic on TIM s and the fixed network. In May 2006, the value of the bonus was increased to 1,000. In October 2006 we launched SeiTIM , a special rate reserved for customers who transfer to TIM through MNP. Sei TIM allows a special rate of 6 eurocents per minute for all domestic calls, with a connection charge of 16 eurocents, valid for one year.
- **Gross acquisitions, Prepaid.** In January 2006 we launched Parli Gratis, a promotional rate of 0 eurocents per minute with a connection charge of only 3 eurocents, valid for 30 days and renewable based on the expense threshold. In June 2006, the rate plan was enhanced by an automatic bonus based on incoming traffic.

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- **Roaming, Rate Plans.** In response to the price reductions required by the European Commission, in December 2006, Telecom Italia launched the new TIM Zero Confini roaming rate plan which provides its customers with a simple, advantageous rate system for use in the 30 countries of the EU.

By activating TIM Zero Confini, customers can make phone calls and video calls in Europe for 0 eurocents a minute, and only have to pay the connection charge of 1 (including VAT).

The charge is also valid for all the calls received while abroad and for the first 5 minutes of every phone call or video call made in one of the 30 countries, up to a maximum of 100 calls. Any calls made over and above the ceiling imposed will be charged at the normal rates applied to calls made or received while abroad.

The special rate is valid for 30 days from the date of activation and costs 10 (including VAT). In the case of MNP, activation is free.

The countries where TIM Zero Confini is applicable are: Austria, Belgium, Bulgaria, Greek Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Great Britain, Greece, Hungary, Iceland, Ireland, Latvia, Liechtenstein, Lithuania, Luxembourg, Malta, The Netherlands, Norway, Poland, Portugal, Romania, the Slovak Republic, Slovenia, Spain, Sweden and Switzerland.

- **Super UMTS Hi Speed.** On July 3, 2006, Telecom Italia began to market the new small UMTS Hi Speed/HSDPA (High Speed Downlink Packet Access) handsets which allowed access to broadband at a speed of up to 1.8 Mbps.

In November 2006, this speed was raised to 3.6 Mbps, thus further improving surfing potential and ensuring a better quality of service than normal UMTS.

All inclusive packages were launched to promote data services using HSDPA technology, including mobile Internet surfing and hi-speed PC card products (Tutto Relax Internet, Internet Relax):

Tutto Relax Internet involves the acquisition (at advantageous terms) of a HI speed PC card ( 49) and payment by installments for the HW and traffic for 12 months with installments starting at 19.95 per month;

Internet Relax involves the acquisition (at advantageous terms) of a HI speed PC card ( 99) and payment by installments for the HW ( 12 per month); the installments are cancelled if the customer decides to activate one of the Web rate plans available (WEB time, WEB facile).

- **DVBH.** TIM s DVBH (Digital Video Broadcasting Handheld) service, TIM TV, is currently available in 3,000 towns in Italy, with a coverage of about 69% of the population.

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The first handsets to be available were the Samsung SGH-P920, the Samsung SGH-P930 and the Brionvega 7100. The basic TIM TV service offers viewing on 8 channels: Canale 5, Italia 1, La7, MTV, Sky TG24, Sky Sport 24, Sport Italia and Sky Meteo. The monthly cost of activating TIM TV is 5. The activation of TIM TV includes the chance to watch the TIM Serie A soccer matches and the best of European soccer for the whole of the 2006-2007 season.

Customers can also choose to purchase a UMTS/DVBH handset through the TIM TV Telefono Relax rate plan. With TIM TV Telefono Relax, the customer pays an advance of 199 and a fixed monthly payment of 10 for 24 months. But if the customer is able to guarantee the monthly activation of TIM TV and a monthly expenditure of at least 25 in domestic calls, the 10 monthly charge is waived.

Another way of acquiring a UMTS/DVBH phone is to select the TIM TV Tutto Relax rate plan. TIM TV Tutto Relax offers customers the chance to pay an advance of 99 and 24 monthly installments of 1 each. In addition, against payment of a monthly charge of 49, the customer benefits from a bundle of services. The bundle includes: access to the basic TIM TV service, 1,000 free SMS per month, 1,000 minutes of calls and video calls at 0 eurocents a minute with a connection charge of 16 eurocents per call. All prices are inclusive of VAT.

### V **MARKETING AND DISTRIBUTION**

At December 31, 2006, Domestic Mobile's physical distribution network consisted of 4,838 Points of Sale (POS) belonging to 1,685 distribution partners and 35 shops owned by Telecom Italia.

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The Points of Sale are geographically widespread and of many different types which we believe provide us with a significant competitive advantage in marketing our products throughout Italy and in all the market segments.

Our sales network consists of various types of POS, which reflect different approaches to the market. The shops called *Il Telefonino*, which consist of both direct and franchised outlets (5%), represent the corporate image and specialize in the sale of high value services. The *Centri TIM-Alice*, which are specialized monobrand shops, offer products to mass customer segment, targeting volumes and quality of distribution. Telecom Italia is also present in large multibrand shops.

**V THE MOBILE NETWORK**

The mobile network consists of the 2G (second generation) network, which includes GSM equipment, and the 3G (third generation) network, for UMTS equipment offering hi-tech services (also video).

The Telecom Italia GSM/EDGE network consists of approximately 13,865 radio base stations and 720,720 radio channels (an increase of 1% compared to 2005). Planning and implementation of the UMTS network continued, so that coverage was extended to all the regional capitals, in accordance with the obligations laid down in the 3G license, and many other areas of interest. The Telecom Italia UMTS network consists of approximately 8,027 radio base stations and 778,976 radio channels (an increase of 216% compared to 2005).

Work has begun on the network plan to distribute the HSDPA (High Speed Downlink Packet Access) service, the aim of which is to increase the speed of the data transmission package offered by UMTS.

About 3,500 radio stations of the UMTS access network (the so-called node B), have been updated so that they can distribute the above-mentioned service.

The process of modernizing the GSM exchanges with older technologies has begun, so that new technologies can be adopted. These systems will have an architecture which is the same as those used on the UMTS network. These exchanges have *layered* or *split* technology, (both terms are used), in which the Monolithic MSC is replaced by an exchange with two junctions: the MSC server which controls the traffic and the MGW (Media GateWay).

This innovation will make it possible to implement an integrated GSM/UMTS network, as far as this is possible, which, with time and the necessary measures in terms of size and operations, will eventually create a configuration where the switching exchange is shared by the GSM and UMTS access systems. The aim of all this is to make improvements in the management of the service that will lead to a so-called *seamless* scenario.



**4.2.4 BRAZIL MOBILE**

The Telecom Italia Group operates in the mobile telecommunications sector in Brazil through Tim Brasil (our indirect wholly owned subsidiary of Telecom Italia) which offers mobile phone service using GSM and TDMA technology.

The Tim Brasil group is composed of the following:

**Brazil Mobile**

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Tim Brasil S.A.

- Tim Participações S.A.
- Tim Celular S.A.
- Tim Nordeste S.A.

**V GENERAL**

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

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In 2006, the Brazilian market continued to expand although at a slightly slower pace than in 2005. At the end of 2006 there were 99.9 million lines (53.2% penetration of the population), compared to 86.2 million in 2005 (47.2% penetration). The Tim Brasil group reinforced its position as the second-largest operator with 25.4 million lines, of which more than 90% are GSM. Its market share increased to 25.4% from 23.4% at the end of 2005 and the gap between the group and the largest operator closed even further (11 percentage points at the end of 2005 compared to less than 4 percentage points at the end of 2006). In the last quarter of 2006, Tim Brasil was Brazil's market leader in terms of revenues.

These results were achieved due to the leadership of the Tim Brasil group on the GSM market, which, in 2006, grew more quickly as a result of the improvement in the quality of national coverage. In 2006, the strategy of the Tim Brasil group focused on:

- improving Customer Care activities so as to augment levels of loyalty and retention;
- investing in the brand image to strengthen the group's leadership position;
- greater segmentation of the offering to limit the churn rate, especially in high spend segments, and stabilizing the ARPU as a whole;
- reducing acquisition costs for customers, especially with regard to subsidies for purchasing handsets; and
- increasing the levels of VAS use, including Data and messaging services by the Business customers.

Lastly, in 2006, Tim Brasil reorganized its corporate structure; this should streamline operations and also lead to more effective financial management.

**V SERVICES PROVIDED**

In 2006 Tim Brasil extended GSM coverage to 165 more towns in Brazil, bringing coverage to about 160 million people (85% of the total population) to encourage the migration of customers from TDMA to GSM.

At December 31, 2006 the total number of customers (source KPI Network) was 25.4 million, of which 23.1 million used the GSM technology and 2.3 million used TDMA technology.

During 2006, 557 new GSM Base Transceiver Station (**BTS**) were introduced to the network, bringing the total to 8,903 (the number of TDMA BTS remained almost constant at 2,362), 10 Base Station Controller (total equal to 133), 5 Mobile Switching Center (total equal to 55) and 3 HLR (total equal to 14).

The main initiatives during 2006 also involved:

- the introduction of the split architecture to extend the GSM Core Network;
- launch of the COPA (Home Zone) service: calls originated within a local area and terminated with fixed numbers within the same area are managed on the basis of a differentiated charging system;
- the optimization of existing leased lines, leading to a reduction of operating costs;
- extension of the NGN IP backbone to support Long Distance traffic.

V **MARKETING AND DISTRIBUTION**

In 2006, the services of the Telecom Italia Group in Brazil were marketed through the country's largest distribution network, consisting of about 8,500 Points of Sale ( **POS** ) dedicated to retail customers. In terms of composition, 8% of these POS are owned or franchised shops and 29% are owned by exclusive dealers. The remaining 63% are multi-brand POS of organized large-scale distribution, a channel which focuses on providing an adequate level of representation throughout the territory covered by the company's mobile services. Furthermore, again with respect to the retail channel, the company relied on more than 250 thousand POS to provide top-up services.

With regard to the business segment, in 2006, the company had more than 150 direct exclusive sales outlets for large companies (Key Account Managers) and a network of more than 600 partner agencies (Tim Business Promoters) dedicated to small and medium-size companies.

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The Media Business Unit operates in the following segments:

- the **Television Business Area** operates in the sector of producing and broadcasting content through the television broadcasting networks (La7 and MTV) operated under concession nationally and through digital networks, and in the marketing of advertising space in TV programming. It also operates as a television broadcasting network operator using analog and digital technology. Furthermore, Television manages satellite channels and pay-per-view services using Digital Terrestrial TV (DTT);
- the **News Business Area** operates through TM News, a leading national news agency with a marked international connotation. It was conceived as the result of a partnership with Associated Press (AP) and provides news on a 24 hour basis as well as analyses, special reports, and regular reports from its offices in Rome and Milan and from abroad: Brussels, New York and Budapest.

As of December 31, 2006, the Business Unit was organized as follows:

**MEDIA**

| <b>Television</b>                        | <b>News</b>               |
|--|---------------------------|
| Telecom Italia Media S.p.A.              | Telecom Media News S.p.A. |
| Telecom Italia Media Broadcasting S.r.l. |                           |
| MTV Italia S.r.l.                        |                           |
| MTV Pubblicità S.r.l.                    |                           |

**V KEY FACTORS**

The sale of Gruppo Buffetti and the merger of La7 Televisioni S.p.A. with Telecom Italia Media S.p.A., in January 2006, completed the process of rationalizing the activities of the Telecom Italia Media group which began in 2005. As a result of this reorganization process and the important capital expenditures program implemented in the prior year, Telecom Italia Media has strengthened its position on the media market and intends to seize the opportunities offered by the rapid evolution of new platforms (Digital Terrestrial TV, DVB-H (Digital Video Broadcasting-Handheld), IPTV (Internet Protocol TV), etc.), consolidating its identity as a multimedia, multi-platform operator, having carved itself a reputation as one of the most dynamic operators on the Italian market.

**V TELEVISION**

- **Digital Terrestrial Television**

Television manages pay-per-view services using Digital Terrestrial Television (DTT).

During the new Serie A return soccer championship in Italy, the commercial Digital Television offering La7 Cartapiù continued to broadcast events of 10 of the 20 Serie A teams, either singly or as a package. At December 31, 2006 approximately 1,066,900 La7 Cartapiù had been put into circulation and about 65% of them had been sold.

June 2006 saw the launch of the *Estate Musica* offer, a new series of concerts by important Italian artists, which can be acquired singly or as a 30-day package.

During 2006, the pay-per-view service was further improved and extended both by introducing stereo sound and dual sound (enabling customers to choose a different commentator to the one offered by the main channel) and the launch of the interactive t-betting application, pursuant to which owners of SNAI Cards can bet on all the Serie A soccer games by tuning in to the La7 Cartapiù and La7 Sport TV channels. The number of points of sale selling the smart cards increased, with the new tobacconist and newsagent channels. Communication activities on La7 Cartapiù continued: an autopromo campaign on the analog La7 channel and the digital La7 Cartapiù channels, in the sports sections of daily newspapers until the end of the soccer championship, and a poster campaign in the largest Italian cities.

- **La7 Free to Air**

La7 provides news information on a 24-hour basis.

During the first half of 2006, the audience for La7 seemed to be mainly interested in information, analysis and political discussion in the period running up to the elections in April 2006. In January and

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February 2006, the network's average audience share was 2.9%, an increase of 13% compared to the same period in 2005. The credibility and style of programs broadcast by La7 have become a benchmark for an ever-wider audience which particularly favored its early-morning news and talk show programs (Omnibus and Omnibus W.E.), the usual programs broadcast in the evening such as *Otto e mezzo* and *L'infedele* and the various editions of the News.

In the spring 2006, the increase in the audience share was even more significant with an average of 3.1% (+19% compared to 2005). Contributors to the increase in the evening audience share included the talk show *Le Invasioni Barbariche*, which confirmed the success of the previous year, and the talk show *Crozza Italia*.

During the summer period of July and August 2006, the average audience share reached 3.2% with an average growth of 16% compared to 2005, and an increase of 26% for the daytime segment.

The autumn program schedule contained several novelties in the field of information and entertainment, sport, programs with a scientific slant and fiction. In 2006 La7 reached a 3% average daily share, continuing the growth trend seen in previous years; in 2006, after peaking in the summer, the figure fell to 3% in the last three months of the year, against a backdrop of intense competition starting in September.

- **MTV**

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

During 2006 MTV maintained its leadership position in audience share with 8,850,000 daily contacts, an increase of 5% compared to the previous year and 15.8 million weekly contacts and has been making constant progress since 2001, according to Makno & Consulting's Television System Observatory published in May 2006.

The positioning of music, the network's core business, was further enhanced by two new programs: *Our Noise* (an hour of music looking at the most interesting new releases) and the charts program *MTV 10 of the Best*.

v **NEWS AREA**

TM News is a national news agency operating on a 24-hour basis. It operates under the APCOM brand. The main Rome office is supported by the editorial office in Milan and correspondent offices in Brussels, Budapest and New York. Its position is strong with regard to international coverage and quality (editorial standing) and quantity (average daily production of more than 900 news items) of its journalistic production.

In June 2006, the News area renewed its exclusive contract for Italy until 2010 with the Associated Press, whose news the channel translates into Italian and then distributes. It now has an updated logo which is a graphic representation of the partnership, and the offering of news bulletins has been further enhanced. The process of updating the production and distribution platforms continues in order to industrialize the multi-platform management of printed and multimedia content.

#### **4.2.6 OLIVETTI**

The Olivetti Business Unit (which changed its name on April 5, 2005 from Olivetti Tecnost to Olivetti) operates in the Office Products Division in the sector of ink-jet products for the office, digital printing systems and the development and production of products associated with silicon technology (ink-jet print heads and MEMS), and also specialized applications for the banking field and commerce and information systems for gaming and lotteries. The reference market of the Business Unit is focused mainly in Europe and Asia.

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As of December 31, 2006, the Olivetti Business Unit included the following companies:

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**OLIVETTI**

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Olivetti S.p.A.

- Olivetti I-Jet S.p.A.
- Olivetti International B.V.

(foreign sales companies)

Since 2006, the Olivetti Business Unit has operated with a new organizational structure based on the Business & Market Development area (responsible for all marketing and sales) and the Product/Technology Development & Industrial Operations area (responsible for manufacturing, research and logistics).

**V KEY FACTORS**

In 2006, Olivetti focused on improving its sales force, industrial reorganization and renewal of its products.

In a highly competitive market, work continued on a new line of multifunctional products and on strengthening the company's position in the main European markets. Significant results were achieved in terms of volumes of new products and new business for specialized terminals.

The restructuring and rationalizing process at the manufacturing and technological level also neared completion. This involved:

- the restructuring and concentration of production hubs mainly for specialized terminals and gaming products;
- the centralization of research and development activities.

Product offers continued to be updated and expanded, including:



- the launch of new multifunctional products based on ink-jet technology, achieving the goal fixed in terms of cost reductions and product range expansion;
- the optimization of the mix of traditional products and strict cost controls.

V **BUSINESS AND MARKET DEVELOPMENTS**

The year 2006 was marked by pricing pressure for hardware. In addition, significant efforts were made in the commercial sphere to augment the company's visibility and presence in the channels specialized in the new line of products based on ink-jet technology (multifunctional printers and portable photo printers). As a result, significant sales volumes were obtained in the main European and South American markets.

In the second half of the year, the product range was expanded by the introduction of the new multifunctional entry-level printer models, along with others with Wi-Fi functions.

The sales of other ink-jet products, fax machines, declined in the European market which resulted in even fiercer competition with regard to prices. Consumption of fax accessories reported a decrease in volumes owing to a stronger presence in the consumer area than in the business area.

Sales of the other product lines, photocopiers and office products based on laser technology, printers for banks and the retail market and cash registers increased compared to the same period of 2005 because of greater integration among sales channels as a result of the new organization which brought the entire product portfolio offering to every customer. In particular, sales of printers for banking increased by 18% compared to the prior year.

As far as the large customer market in Italy is concerned, the offering was expanded by participating in important bids for multi-year contracts for complete ticketing services and network printing/copying systems with customers like Poste Italiane, Ferrovie (the Italian railway operator) and Italian banks. In this context, in July 2006, Olivetti won a bid to supply printing/copying services for Poste Italiane worth 13 million.

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**V PRODUCT/TECHNOLOGY DEVELOPMENTS & INDUSTRIAL OPERATIONS**

The main activities in 2006 in the consumer ink-jet technology segment were as follows:

- restyling of the range of multifunctional products launched in 2005 and the extension of the product range with the introduction of a fax model (with printer, photocopier, scanner and fax functions);
- introduction of a new multifunctional entry-level product;
- development of a new platform of multifunctional products and associated high-performance print heads, scheduled to become available in the first half of 2007;
- the introduction of new fax models.

In the professional products sector, the following took place:

- activities aimed at updating and expanding printers for banks;
- completion of the range of traditional fiscal cash registers and the development of a fiscal cash register using ink-jet technology.

**4.2.7 OTHER TELECOM ITALIA GROUP ACTIVITIES**

The Other Activities of the Telecom Italia Group consist of the Central Functions (Group Functions and Service Units) and the foreign operations which are not included in other Business Units (Entel Bolivia, Sofora and ETECSA).

**V CENTRAL FUNCTIONS**

Central Functions includes Group Functions and the Service Units.

The Group Functions are responsible for ensuring coordination, direction and control at the Group level in their spheres of activities, whereas Service Units are responsible for ensuring the performance of common operating activities to support the business.

Group Functions include the Staff Functions of Telecom Italia (Human Resources & Organization excluding the Welfare function which is under the Service Units, Finance Administration & Control, Corporate & Legal Affairs, International Legal Affairs, Public & Economic Affairs, Corporate Development, Investor Relations, General Counsel and IT Governance), Group Communication, which includes Progetto Italia, Advertising & Image and Media & Opinion Maker Relations, Telecom Italia Latam and Telecom Italia International.

Starting January, 1, 2006, the former TILAB (now Innovation & Engineering Services) and Information activities were transferred to Operations.

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

**V ENTEL BOLIVIA GROUP**

Telecom Italia International holds, indirectly, a 50% stake in Entel Bolivia, the Bolivian telephony operator which was acquired in 1995.

The Entel Bolivia group operates in the fixed (particularly long-distance national and international telephone segments), mobile, internet and data transmission sectors in Bolivia.

In 2006, the fixed telephony business continued to focus on the commercial sphere, and in particular on the Aquí Entel (public service) initiative. This initiative, used mainly for local calls to mobile phones but which has capacity limitations (it is based on accesses with mobile technology), reported a growth in the number of lines of approximately 77% compared to December 2005 (21,970 at December 31, 2006 compared to 12,383 at December 31, 2005) and an increase in revenues mainly due to a 51% increase in local traffic volumes. At the

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same time, there were changes in rates and promotions aimed at increasing international long-distance traffic which, together, made it possible to completely offset the losses reported in the same telephony segment in the first half of the year.

At December 31, 2006, the number of fixed lines (74,000) increased by 29.8% compared to December 31, 2005 (57,000).

During 2006 Entel Bolivia's mobile business suffered fierce competition from the operator Telecel which launched its own GSM service (under the Tigo brand). Telecel's offers, which included subsidies for acquiring handsets and the possibility of operating above 850 MHz and various offers by Viva caused a loss of market share of approximately 10% compared to December 31, 2005, especially in La Paz and Santa Cruz and in the east of the country. In order to limit the damaging effects of competition, Entel Bolivia launched new rate plans in the second half of 2006, with the aim of increasing customers and mobile-mobile traffic. Also, in November 2006, the 2x1 (dos por uno) rate plan was launched, enabling customers to use twice the value of the top-up or, for customers with postpaid traffic, twice the number of minutes of their subscribed rate plan. Due to this plan, it proved possible to reverse the trend of the monthly variation in customers which had been negative since January 2006.

In the Value Added Services ( **VAS** ) sector, starting from August 2006 charges were reduced for GPRS and Edge services to make them more competitive than the services offered by Tigo, which had also adopted an aggressive sales policy for these types of services.

The number of mobile lines at December 31, 2006 (equal to 1,443,000) was in line with December 31, 2005 (1,447,000) after having recovered the reduction in the number of lines after cleaning out the customer base (about 61,000 lines) and fierce competition.

Please see 4.1.5 Recent Developments During 2007 about the possible nationalization of Entel Bolivia.

**V TELECOM ARGENTINA GROUP**

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

Telecom Argentina group operates in the sectors of wireline and mobile telephony, Internet and data transmission in Argentina and also offers mobile telephone services in Paraguay.

At December 31, 2006, there were approximately 4,095,000 fixed lines in service (also including installed public telephones), an increase of 3.7% compared to December 31, 2005.

Telecom Argentina's broadband business grew significantly during 2006 and reached a total of approximately 448,000 customers, an increase of 103% compared to December 31, 2005.

In the mobile business, the customer base of the Group reached approximately 9,589,000 (12.1% of which is in Paraguay) with an increase of 41% compared to December 31, 2005. The number of postpaid customers increased by 35.8% compared to December 31, 2005 and represents 31.6% of the total customer base (compared to 32.8% at the end of 2005). Customers who use GSM services reached 86.7% of the total customer base.

**V ETECSA**

Through Telecom Italia International we hold a 27% interest in ETECSA, the monopoly provider of fixed line and mobile telecommunications services, Internet and data transmission in Cuba.

Old Telecom Italia obtained an initial stake of 12.25% in ETECSA in 1995, when, prior to its privatization by the Italian government, Old Telecom Italia acquired, for approximately U.S.\$291 million, a 25% stake in a Mexican telecommunications company which owned 49% of ETECSA. In February 1997, Old Telecom Italia converted its indirect stake in ETECSA into a direct investment and increased its interest to 29.29%. The acquisition price for such further 17.04% stake in ETECSA was U.S.\$291.6 million. In connection with the merger of the local mobile operators into ETECSA to form an integrated provider of telecommunications services we participated in a series of capital increases proportionate to our share ownership.

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These capital increases occurred during 2003 and through 2004; during this period we invested an additional U.S.\$41.3 million in ETECSA through capitalization of dividends paid by ETECSA and following these capital increases and the mergers we now own 27%. The other shareholders in the company include the Cuban government which controls 51% of the company and four other Cuban shareholders.

In addition to our shareholding in ETECSA Telecom Italia International is a party to a shareholders' agreement pursuant to which it has the right to designate certain senior executive officers and a majority of the board of directors of ETECSA on alternate years.

In addition to these governance arrangements we entered into agreements to provide certain technical assistance to ETECSA with respect to its fixed line and wireless services.

In return for these services we receive annual fees of U.S.\$900,000 (for fixed line technical assistance) and 950,000 (for mobile technical assistance) under each agreement respectively and certain other fees for specific services provided ( 771,477 in 2006 and 1,518,000 in 2005). The level of the fees earned over the last two years is set forth in Note 41 Related Party Transactions to Notes to our 2006 Consolidated Financial Statements included elsewhere herein. The technical agreement with respect to fixed line services, renewed at the beginning of 2007, will expire at the end of 2009 and the technical agreement with respect to wireless services at the end of 2009.

As we own only 27% of ETECSA we account for its results under the equity method. For further details see Note 8 Other Non-Current Assets to Notes to our 2006 Consolidated Financial Statements included elsewhere herein.

The number of fixed lines (also including installed public telephones) was approximately 973,000 at December 31, 2006, an increase of 14% compared to December 31, 2005. Of the lines installed, 49,000 are invoiced in US dollars and the others, connected to the social development of Cuban telecommunications, in pesos.

In 2006, the number of Internet and data customers increased and, at December 31, 2006, had reached about 20,000 accesses (compared to 16,000 at the end of 2005).

In the mobile business, at December 31, 2006, the customer base had reached 152,700, an increase of 16% compared to December 31, 2005. The increase is mainly concentrated on the prepaid customers, which represents almost 90% of the total. In 2006, the migration of customers from TDMA towards GSM technology continued and is now used by 81% of the total customer base (compared to 70% at the end of 2005).

We do not believe that our arrangements with, and investments in, Cuba are material to the results of operations or financial condition of the Telecom Italia Group, taken as a whole.

\* \* \*

## Brasil Telecom

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

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

On October 27, 2006, Telecom Italia International transferred, for U.S.\$410 million, its 38% stake in the share capital of Solpart Participações S.A. (the controlling holding company of Brasil Telecom) to Brasilco S.r.l., a newly incorporated Italian company held by a trust set up under British law, with Telecom Italia International itself as the beneficiary. Under the trust deed, Credit Suisse Securities (Europe) Limited ( **CSFB** ) acts as the trustee managing the stake and the corporate rights deriving there from, also for the purpose of selling the stake to third parties with the assistance of JP Morgan which have been engaged to evaluate possible sales opportunities. Telecom Italia International, as the sole beneficiary of the trust, will continue to receive any earnings from the investment in Solpart, including the price of its future sale.

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As a result of the above transfer, approved in advance by the Brazilian telecommunications authority, Anatel, Telecom Italia International transferred ownership of the Solpart shares and the relative governance rights, thus resolving the question concerning the overlapping of the mobile and long-distance licenses between the Brasil Telecom group and the TIM group in Brazil and consequently avoiding the possible application of sanctions by Anatel to the two operators.

During December 2006, Brasilco S.r.l. collected U.S.\$4.5 million representing its share of a capital reimbursement approved by the shareholders meeting of Solpart Participações S.A.. On January 29, 2007, this amount was transferred by Brasilco S.r.l. to Telecom Italia International as a reimbursement of reserves.

#### **4.2.8 COMPETITION**

Our domestic fixed and mobile telecommunications operations, as well as our broadband services businesses, are subject to extensive regulatory requirements in Italy and our international operations and investments are subject to regulation in their host countries. In particular, as a member of the **EU**, Italy has adapted its telecommunications regulatory framework to the legislative and regulatory framework established by the EU for the regulation of the European telecommunications market. The EU Commission approved a new electronic communications framework in March 2002, which has been effective in Italy since September 2003.

#### ***Fixed-line Domestic Telecommunications Services Market***

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

In 2006, competition in the Italian domestic market was characterized by innovative offerings through the introduction of bundled voice/broadband (double play) and bundled voice/broadband/IPTV (triple play) offers. The market was also characterized by a migration from a primarily reseller approach (Carrier Selection/Carrier Pre Selection for voice and Wholesale for ADSL) to an infrastructure-based approach (Shared Access or Local Loop Unbundling).

In particular, in 2006 competition in the Italian domestic market was driven by five players (other than Telecom Italia) with differentiated business models and focus on different market segments:

- Fastweb (a national player focused on broadband and triple play offers);
- Albacom (focused on business customers and ICT offers: voice, data and IT solutions);



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- Wind-Infostrada (an integrated fixed/mobile/Internet operator focused on retail customers);
- Tiscali (a Narrow Band and broadband Internet Operator, developing double play/VoIP low cost offers); and
- Tele2 (voice, Internet dial up and broadband, developing discounted double play /VoIP offers focused on retail customers).

Our market share in the Italian retail traffic volumes (retail voice and on-line traffic only) on December 31, 2006, was 71.9% compared with 72.3% on December 31, 2005 and 71.7% on December 31, 2004. Our main competitors in this segment are Tele2 and Wind; Albacom and Fastweb target specific markets (business customers for Albacom; high spending consumers for Fastweb).

The Italian fixed voice market has been influenced, on one hand, by the development of mobile operators that attract voice traffic through the advantage of mobility, a wide range of VAS and high performance terminals, while, on the other hand, it has been subject to cannibalization by the increasing penetration of alternative communication solutions (messaging, e-mailing, chat).

The broadband market continued to grow but at a slowing rate and subject to increasing competition.

In 2006, competition intensified also in the top client/data market, with pressure on average prices.

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In this increasingly challenging market Wireline Business Unit revenues in 2006 decreased by 0.2% compared to 2005, while maintaining a level of profitability at the top of its peers' range.

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

***Domestic Mobile Telecommunications Services Market***

In 2006 the mobile telecommunications market continued to grow in Italy but at a rate slower than in the previous two years. Customer growth in the domestic mobile telecommunications market was 12.5% in 2006, compared to 13.2% in 2005 and 10.8% in 2004. As of December 31, 2006, the number of cellular phone lines reached 80.4 million, corresponding to a penetration rate of around 137% of the population.

There are three key competitors for Telecom Italia in the Italian mobile market: Vodafone, Wind and H3G (called "3"). At December 31, 2006, Telecom Italia held the market leadership with a market share of 40.4%, with Vodafone, Wind and H3G having market shares of approximately 32.5%, 18.4% and 8.8%, respectively.

In 2006, we had a 43% market share of net additional GSM and UMTS lines, corresponding to 3.9 million net lines, compared to 2.4 million for Vodafone, 1.0 million for Wind and the remaining 1.6 million attributable to H3G.

Our figures do not include inactive lines to ensure greater consistency between the number of lines managed and business development.

Competition for mobile telecommunications services remained strong in 2006, and Telecom Italia responded with:

- a strong commercial push to defend market leadership;
- innovative and segmented offers;
- a volume and value strategy:

pushing on gross additions to slow competitors' growth (Wind, H3G);

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securing the competitive gap on valuable customers (TIM vs. Vodafone), also through value oriented mobile number portability with a focus on high end customers;

- leveraging the benefits from fixed and mobile integration:

strengthening the distribution channels;

price defense (no price war in fixed/mobile substitution);

- focus on handsets leadership (7.4 million handsets sold in 2006):

TIM 3G successful strategy: 300,000 HSDPA handsets sold in 2006;

- solid positioning in the small and medium enterprise segment;
- focus on customer care and quality of service.

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

### ***The European broadband Market***

#### *German broadband Market*

Germany is the first broadband market in Europe measured by size: 15 million broadband accesses, approximately 8 billion in value, and it continues to grow rapidly. It is characterized by:

- five main competitors and room for further merger and acquisition activity following the recent consolidation process;
- an increase of alternative operators, LLU coverage and early stage VDSL/Fiber Network projects;
- the increasing penetration of dual and triple play offers;

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### **Business Units**

- an **ARPU** of 40-50 /month for bundle Voice + DSL, higher than the European average and without dramatic reductions expected in the short term;
- the appearance of Fixed Mobile convergent offers (mobile operators O2 and Vodafone announced the entry in the DSL market).

HanseNet strong performance in 2006 was based on:

- a robust increase in the ADSL customer base (approximately 929,000 broadband access lines at the end of 2006);
- strong focus on network coverage, reaching 40% of German households in the fourth quarter of 2006;
- continuous improvement in profitability driven by operational efficiency.

In September 2006 Telecom Italia reached a preliminary agreement for the acquisition of AOL Germany's Internet business from Time Warner. This transaction was completed on February 28, 2007. The combined entity HanseNet plus AOL has become the third broadband player in Germany with approximately a 15% market share. The other main broadband operators are: T-Online with 41% market share, United Internet with 16% market share, Arcor with 13% market share and Freenet + Tiscali with 8% market share.

### *French broadband Market*

The French broadband market reached approximately 13 million broadband accesses in 2006, corresponding to a penetration of 40% on total fixed lines, and it continues to grow at a rapid pace. It is characterized by:

- strong competition, focused on portfolio innovation (launch of ADSL 2+, first market for VoIP and IPTV penetration in Europe);
- a stabilization of triple play average prices (approximately 30 /month for all players);
- room for further merger and acquisition activity despite recent consolidation events (i.e. merger Neuf/Cegetel and following acquisition of AOL France, Tele 2 acquisition by SFR).

Telecom Italia France performance in 2006 was characterized by:

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- the consolidation of its market position through an increase in the ADSL customer base, reaching 775,000 broadband accesses in December 2006 (+43% vs. 2005);
- the increase of market share (from around 6% at the end of 2005 to approximately 7% at the end of 2006). The other main competitors are: France Telecom with 49% of market share, Iliad with 19% market share, Neuf/Cegetel with 18% market share and Club Internet with 5% market share;
- a strong focus on LLU network coverage, reaching 36% of fixed lines in the fourth quarter of 2006 (approximately 11 million households);
- the continuous recovering of EBITDA margin.

### **The Brazilian Mobile Market**

In 2006, the Brazilian telecommunications market growth was driven by mobile and broadband services development.

The fixed line market (voice and broadband) still accounted for 60% of the total telecommunications business and approximately reals 46 billion in revenues, representing an opportunity for challengers of fixed-line operators.

The mobile services market continued to grow, but at a slowing rate compared to 2005. As of December 31, 2006, the number of cellular phone lines reached 99.9 million, corresponding to a penetration rate of around 53.2% on the Brazilian population (86.2 million lines in 2005; penetration rate of 47.2%).

There is significant competition in the Brazilian mobile business, with both local and international mobile operators, the most significant of which are Vivo with 29.1% market share, Tim Brasil with 25.4%, Claro with 23.9% and Oi with 13.1%. Tim Brasil, the only mobile operator with national GSM coverage, was the best performing operator in net customer additions (+5.2 million lines, +2 percentage points in total market share), reaching, as of December 31, 2006, 25.4 million lines, compared to 20.2 million lines as of December 31, 2005.

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### Regulation

#### 4.3 REGULATION

##### The E.U. Regulatory framework

Italy is a member of the EU and, as such, is required to implement the directives issued by the EU.

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 Regulatory framework in Italy

The law sources for the electronic communications sector are as follows:

- the Electronic Communications Code ( **ECC** Legislative Decree No. 259 of August 1, 2003) which incorporated into national law the EU directives of the 1999 Review with regard to electronic communications networks and services: the Framework directive together with three directives Access , Authorization and Universal Service ;
- the Consolidation Act on Radio-Television (Legislative Decree No. 177 of July 31, 2005,) which contains the principles for convergence between radio-television and other sectors of interpersonal communications;
- Legislative Decree No. 262 of October 3, 2006, which contains Urgent measures with regard to tax and financial matters and which, with reference to the ECC, partially altered the law on sanctions by introducing further examples of administrative offences, a generalized increase in the fines for each sanction and the elimination of the institution of the partial cash settlements of fines.

The main characteristics of the ECC 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;

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- 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 ECC provides for guidelines on market analysis and calculation of significant market power and refers to the relevant European Recommendation for the identification of the retail and wholesale markets. The ECC also provides for, among other things, the following:

- allows the trading of the rights to the use of frequencies among operators offering the same type of services;
- provides for specific and more defined rules aimed at reducing the burden of current legislation and local regulations which regulate the installation of networks; and
- assigns roles and responsibilities among the Italian Ministry of Communications and the National Regulatory Authority ( **NRA** ) mainly by assigning to the Ministry of Communications the task of supervising the authorization process and compliance with the universal service obligations and to the NRA the task of conducting market analyses and proposing remedies.

The NRA, an independent regulatory authority, consists of a President appointed by the Italian Government through a Presidential decree, a Committee for Infrastructures and Networks, a Committee for Products and

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**Regulation**

Services and the Council. Each of the Committees' members is selected by the Italian Parliament and appointed through a Presidential decree. Each of the Committees and the Council is responsible for establishing regulations for their specific areas.

The NRA has the dual responsibility of (i) ensuring fair competition among telecommunications operators; and (ii) protecting consumers. In particular, the NRA is responsible for:

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

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

***Universal Service***



The Universal Service is a minimum set of services of a certain quality, which must be made available to all customers, regardless of their geographical location and, taking account of specific national conditions, offered at a reasonable price. To date Telecom Italia is the only operator charged with the obligation of providing the Universal Service throughout Italy. The NRA permits only Telecom Italia to utilize all available means to fulfill its obligation efficiently with regard to cost.

The net cost of providing the Universal Service is calculated as the difference between the Company's net cost when it is subject to the obligations of providing the Universal Service and the net cost of the same operation if the obligation did not exist. It is the NRA's responsibility to verify the net cost.

A fund set up by the Ministry of Communications is used to finance the net cost. Companies in the sector contribute to it, including Telecom Italia.

If, at any time, the NRA determines that the net cost of the Universal Service constitutes an unfair burden for Telecom Italia, it sets off a mechanism to share the costs, which involves payments to the fund by companies in the telecommunications sector.

The NRA is currently conducting procedures to establish the net cost sustained by Telecom Italia to provide the Universal Service during the years 2004 and 2005.

#### ***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

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was presumed to have Significant Market Power if its share of the relevant market was greater than 25%, although the NRA might determine that an operator having a market share greater than 25% did not have Significant Market Power, in view of the operator's ability to influence market conditions and its access to financial resources, or that an operator with a market share lower than 25% had such power.

With the introduction of the new European Framework in August 2003, criteria for the identification of Significant Market Power changed as 18 separate markets were identified and the NRA was asked to carry out a separate Market Analysis in each such market, in order to identify operators with significant market power. The markets identified were divided into retail markets (markets from 1 to 7: access, national and international phone services and leased lines), wholesale markets (markets from 8 to 14: collection, termination and transit, unbundled access, broadband and wholesale circuits), mobile markets (markets from 15 to 17: collection, termination and international roaming) and the television broadcasting services market (market 18).

During 2006, the Italian NRA concluded all of its preliminary inquiries regarding the analysis of the markets and introduced measures as a result of this analysis which are described below.

- **Retail markets**

A general regulatory framework was confirmed for all the retail markets and, in particular, the Price Cap mechanism has been retained for access services and national telephone services. With regard to the access markets, the NRA has required Telecom Italia to provide a Wholesale Line Rental ( **WLR** ) service in those areas where unbundled access services are not provided, with a price which is calculated by means of the retail price index minus pricing method (equal to the retail subscription charges less 12%). When marketing of the WLR service, which will be available by the end of 2007, begins, Telecom Italia is authorized to offer bundled access-traffic rate plans.

The NRA also has removed some of the restrictions for offerings aimed at large business customers together with the obligations with regard to retail leased lines with speeds of more than 2Mbit/s.

- **Wholesale markets**

The NRA has confirmed the continuation of the network cap mechanism for calculating the prices of wholesale collection, termination and transit services and of unbundled network-access services (Local Loop Unbundling and Shared Access). This mechanism also applies to circuits, with the aim of ensuring that cost orientation is used to calculate the prices of the termination and long-distance circuit segments. As far as the price of termination on the networks of other operators is concerned, the NRA has fixed a maximum price equal to 1.54 eurocents/minute, which will remain valid until June 30, 2007, with an annual reduction which will bring the price to 0.55 eurocents/minute by 2011.

- **Mobile markets**

The NRA has not imposed any obligations on the mobile telephone market or international roaming services. On the other hand, it has established a ceiling for termination on the networks of Telecom Italia (formerly TIM), Vodafone and Wind, with a target price of 8.90 eurocents/min. for Telecom Italia (formerly TIM) and Vodafone, and of 9.50 eurocents/min. for Wind for 2008. With regard to H3G, the NRA procedure for establishing the ceiling for termination on the fourth Italian mobile operator has not yet been completed (the process began in July, 2006).

- ***Additional markets***

The NRA is conducting market analysis on three new significant markets (additional markets to the original 18 identified by the European Framework in 2003): mobile collection markets directing calls towards Non-Geographical Numbers (Premium Rates, Freephone numbers and Splitting Charges) (market 15 bis); the market for wholesale termination for international routing (market 19) and the market for retail dial-up Internet traffic (market 20).

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Finally, the NRA has deliberated on the following matters.

Order No. 694/06/CONS: procedure for setting up the Wholesale Line Rental offering in compliance with Order No. 33/06/CONS.

The WLR offering consists of the wholesale sale of the basic and ISDN telephone service associated with the subscription charge paid by residential and non-residential customers who subscribe to the Telecom Italia public telephone network. The marketing of this service and of the mandatory associated services must be made available by Telecom Italia within 12 months of the date on which Telecom Italia was informed of Order No. 694/06/CONS (published in Gazzetta Ufficiale No. 297 on December 22, 2006).

Order No. 504/06/CONS: *Urgent measures fixing the prices of calls to directory information services from mobile networks towards Non-Geographical Numbers (toll free numbers or other numbers without a geographic area code).*

The measure identifies, on a provisional and urgent basis, the mobile networks of Telecom Italia, Vodafone, Wind and H3G as those with significant market power.

A ceiling was established for the prices charged for voice calls on the networks of the mobile operators Telecom Italia (formerly TIM), Vodafone, Wind and H3G, which must not be higher than the current value of the corresponding termination rate, increased by a maximum of 100% for services which are different from and accessory to the simple origination service.

### ***Local Loop Unbundling (LLU)***

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

With the national implementation of the new European framework, the wholesale unbundled access (including shared access) to metallic loops and subloops for the purpose of providing broadband and voice services has been subject to the market analysis procedure.

The NRA decided the introduction, for the years 2006 and 2007, of four baskets of LLU services each of which is subject to a cap of Retail Price Index ( **RPI** ) 4.75% per year. See 4.2.2. Wireline National Wholesale Local Loop Unbundling (LLU) .

***Framework of the fixed access network***

On May 2, 2007, the Council of the NRA launched a public consultation on the *regulatory aspects with regard to the framework of the fixed access network and the future prospects of the new-generation broadband networks* .

The aim of the consultation, which is scheduled for conclusion by mid-July 2007, is to acquire observations and comments from all the parties concerned, with particular reference to the structural characteristics of the market, the technological evolution of networks and services, and the future development of the competition and regulations.

The first matter to be evaluated by the consultation will be the regulatory options concerning the evolution of the public fixed telecommunications network, with particular reference to access by final users.

Secondly, the authority deems that it is important to assess the new regulatory problems arising with regard to promoting the development of the Next Generation Access Networks (NGAN). In fact, on the one hand, there is the problem of forming a regulatory approach which does not constitute an obstacle, but which, on the contrary, will stimulate investments in the networks of the new generation. On the other hand, there is a need to ensure that there is no discrimination and that all operators in the new context of competition and the market are treated fairly.

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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 provide copies of their interconnection agreements to the NRA. Public fixed network operators and leased line service providers having Significant Market Power are required to publish yearly a Reference Interconnection Offer ( **RIO** ).

Telecom Italia has had a number of RIOs approved by the NRA since 2003. On October 28, 2005 Telecom Italia published the RIO 2006. In Order No. 19/06/CIR, the NRA approved, with amendments, the economic conditions of the Telecom Italia interconnection offering for the year 2006. In October 2006, Telecom Italia submitted its interconnection offering for 2007 to the NRA; the proposed offering is currently being assessed.

***Number Portability ( NP )***

Since February 2000, Service Provider Portability in fixed networks was introduced, including Non-Geographic Numbers.

Service Provider Portability allows an end user to retain his number independent of the organization providing service, in the case of geographic numbers at a specific location (same Local Area) and in the case of other than geographic numbers at any location.

NP for mobile services was established during 2001 and commenced in April 2002. On March 28, 2002, the NRA issued Order No. 7/02/CIR which established that the price of Mobile NP ( per number costs ) had to be equal to the one-off price that the operator receiving the customer (the recipient ) had to pay to the operator giving the customer (the donor ). In January 2003, the NRA with Order No. 13/02/CIR set a price cap for the portability charge. This charge can not be higher than the price established for Number Portability between fixed operators.

***Carrier Preselection ( CPS )***

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

Since February 2000, customers have been able to make inter-district, international calls and calls to mobile networks using a pre-selected carrier as an alternative to Telecom Italia, without dialing the identifying code required. Since July 2000 customers have also been able to make local calls (within the same district) with a pre-selected operator.

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

In August 2003, Telecom Italia and other numerous operators signed an agreement regulating the operational modalities for the management of the communication of the CPS service cessation. As from RIO 2005, the surcharge for a single minute of CPS traffic is no longer applied and the one-off activation charge is 5.46 per line.

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

***Accounting separation and costs accounting***

Operators having SMP are required to have an accounting system showing their costs in a transparent manner. Upon request, such operators must provide the NRA with a description of their cost accounting system to verify compliance with the provisions of the electronic telecommunications regulatory framework. Moreover, operators

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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 network, the activities related to the provision of telecommunication services, the interconnection offering and the universal service provision.

The last accounting separation report of Telecom Italia audited by the NRA and published (both on the NRA website and on the Telecom Italia Group's website) relates to 2001.

However, Telecom Italia has provided the accounting separation reports relating to the years 2002, 2003 and 2004 to the NRA. The NRA has appointed Mazars & Guerard with the task of verifying the accounting separation reports for 2002, 2003 and 2004.

The accounting separation report for 2005 is currently being prepared. The activities of that year developed both outside the company (relations with the NRA) with the aim of supervising the specific context with regard to the regulation and the law, and inside the company, with the aim of consolidating the revisions of the methods of the new accounting separation system (Nuovo Sistema di Contabilità Regolatoria, NSAR) and then responding to the new obligations of Accounting Separation for the Markets defined by the new regulatory framework for Italy and the EU as a whole.

In Europe, the rules of Accounting Separation were updated in EC Recommendation No. 2005/698/CE concerning Cost Accounting and Accounting Separation which takes into account the regulation of the various sectors divided according to significant markets.

On a national scale, the NRA issued orders about significant markets, by amending the previous Order No. 152/02/CONS on the subject and establishing new rules for accounting separation and cost accounting, which, however, have not yet been grouped into a single framework.

With this in mind, during 2006, Telecom Italia presented the NRA with a draft proposal for an accounting separation of the fixed network for 2005 divided by market, followed by another project with a more detailed and analytical format which has the aim of: a) providing a single contribution for the concrete realization of accounting separation reports; b) identifying consistent, feasible rules to be applied, with effect from 2005; and c) guaranteeing consistency with Recommendation No. 2005/698/CE.

### ***Directory Information Service***

Since the coming into force of the ECC, the directory information service is no longer a service required to be offered by the Universal Service. This market has been deregulated since October 2005 (now there is a range of directory information services based on 12xy numbers).



In Order No. 12/05/CIR of May 19, 2005, due to the delays in the process of assigning numbers and receiving requests from operators, the NRA established October 1, 2005 as the first day of the new 12xy number service and the end, on the same day, of the Telecom Italia 12 service and on December 1, 2005 the directory information service with numbers beginning with 4 .

This last date was postponed twice by Orders No. 83/05/CIR and No. 18/06/CIR, and was eventually moved to September 30, 2006.

***Rights of way***

The matter of rights of way to permit the building of electronic communications network infrastructures underground and above ground is defined in detail by the ECC.

The ECC describes the powers of local authorities with regard to procedures for granting rights of way, and the powers of the NRA to provide incentives so that operators are encouraged to share the location and use of such infrastructures.

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***General authorizations***

Telecom Italia owns: a) the individual license to install and supply public telecommunications networks and to provide a public voice telephone service; b) the individual license to install and operate a network of coastal stations with the aim of providing the mobile maritime service and land-based stations to provide a mobile service through the Inmarsat satellite.

The licenses described above were issued to Telecom Italia by the NRA on January 19, 2001 with Orders No. 820/00/CONS and No. 738/00/CONS. In March 2001, the licenses for offering mobile communications services based on GSM technology were also transformed into individual licenses.

The ECC has authorized the conversion of all pre-existing rights into general authorizations, and, at the same time, decreed that they will continue to be valid until they expire spontaneously.

At the end of 2006, there were about 160 operators with a general authorization allowing them to operate electronic communications services.

***NRA fee for 2006***

In Order No. 110/06/CONS, the NRA established how operators should pay their fee for the year 2006 and the amounts to be paid.

In particular, for the year 2006, the fee fixed by article 1, paragraph 66 of Italian Law No. 266 of December 23, 2005 and owed to the NRA by companies operating in the communications sector which were identified in the Ministerial Decree of May 17, 2002, in a measure equal to 1.5 per thousand, is calculated based on the revenues recorded in the last financial statements approved prior to the coming into force of the above-described Law No. 266 of December 23, 2005.

The Telecom Italia Group paid an overall amount of approximately 23.9 million for the year 2006 (the sum of the share of the amounts due by Telecom Italia and the former TIM).

***Competition Law***

Telecom Italia is obliged to observe Italian laws concerning the protection of competition.

Italian Law No. 287 of October 10, 1990 ( Laws for protecting competition and the market ) created the Autorità Garante della Concorrenza e del Mercato , or Antitrust Authority, which is an independent body.

The Antitrust Authority is responsible for:

- applying Law No. 287 of 1990 and supervising the following matters: a) restrictive agreements by the competition; b) abuses of a dominant position; c) concentration of enterprises;
- applying the standards of Legislative Decree No. 206 of 2005 with regard to deceitful advertising and comparative advertising; and
- looking out for conflicts of interest in the case of people holding government posts.

### **Regulatory framework in Brazil**

The activities of the Telecom Italia Group in Brazil are subject to the General Law on Telecommunications (Ley General de Telecomunicações LGT) of 1997 and the regulatory framework for the supply of telecommunications services promulgated by the Brazilian regulatory authority, Agência Nacional de Telecomunicações ( **ANATEL** ).

ANATEL is an independent, financially autonomous body which reports to the Brazilian Ministry of Communications.

Authorizations for supplying telecommunications services are granted either in the public sphere (by granting a concession or permit) or in the private sphere (through an authorization).

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At the moment, only a few fixed-network operators operate in the public sphere. All the other telecommunications services operate in the private sphere, including operators of mobile networks.

In 2005, ANATEL published a special set of regulations with regard to operators with Significant Market Power, to which ANATEL intends to apply stricter standards with the aim of guaranteeing competition.

***Authorizations***

When the Telebras system was privatized, concessions for the analog mobile telephone system were granted according to the **SMC** (Serviço Móvel Celular Brazilian Law No. 9295 of July 19, 1996), which involved the granting of concessions, accompanied by a list of obligations, for geographical areas.

Later, ANATEL introduced the standards which allowed SMC concessions to be converted into authorizations, as laid down in the new **PCS** (Personal Communications Services) regulations.

The companies of the Telecom Italia Group operating in Brazil acquired SMC concessions between 1997 and 1998 (later converted into PCS authorizations in 2002) and PCS authorizations in 2001 as a result of bids.

***Rules concerning interconnection***

Telecommunications operators must publish a public offering of interconnection economic conditions and are subject to the General Interconnection Regulatory Framework promulgated by ANATEL in 2005.

The amounts charged for interconnection are freely negotiated among the operators concerned. However, to avoid any detriment to the competition, ANATEL may fix the amounts if the operators do not succeed in coming to an agreement.

Interconnection agreements must be approved by ANATEL before they can be applied.

***Major changes in regulations in 2006***

In Order No. 438 of July 2006 (Resolução 438), the partial bill & keep rule was eliminated. This bill had required an obligation to pay the termination charge only if traffic exceeded 55% of the total in the calls between two mobile operators in the same (local) area.

This decision has had positive results on interconnection revenues and a corresponding negative effect on the costs of interconnection, since each operator must pay (and receive) the termination charge for all the traffic exchanged at the interconnection instead of for a certain share.

### **Regulatory frameworks in France and Germany**

Telecom Italia is represented in France and Germany by some companies which market broadband products under the Alice brand.

The regulatory framework in these two countries is a national transposition of the European Framework defined by the European Directives contained in the 99 Review mentioned earlier.

The regulatory framework of both countries is therefore comparable to the Italian one, with responsibility being shared between the relevant Ministry and an independent Authority (Arcep in France, BNetzA in Germany). Here, too, individual markets with Significant Market Power operators (with their relative obligations) have been identified as a result of an analysis of the relevant markets in those countries.

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Glossary Of Selected Telecommunications Terms

**4.4 GLOSSARY OF SELECTED TELECOMMUNICATIONS TERMS**

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

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

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

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

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

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

**Analog:** A transmission which is not digital, e.g., the representation of voice, video or other 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 and 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; high-speed fax; e-mail for moving images or mixed documents; broadband videotext; 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.

**BSC (Base Station Controller):** Interface with the MSC switching exchange. Has the task of supervising and controlling radio resources, both during the phase when a call is being set up and during the maintenance phase.

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

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**BTS (Base Transceiver Station):** Radio base station which sends the GSM radio signal via the antenna to cover an area (cell) and coordinates one or more radio transceivers (TRX).

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

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

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

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

**Cells:** Geographical portion of the territory illuminated by a BTS: 900MHz / 1800MHz.

**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.

**Client server:** Software programme that is used to contact and obtain data from a Server software programme on another computer. Each Client programme is designed to work with one or more specific kinds of Server programmes, and each Server requires a specific kind of Client. This configuration model is opposed to a Peer-to-Peer configuration, where the contact is performed on the same level.

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



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

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

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

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

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

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

**Digital:** A mode of representing a physical variable such as speech using digits 0 and 1 only. The digits are transmitted in binary form as a series of pulses. Digital networks are rapidly replacing the older analog ones. They

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**Glossary Of Selected Telecommunications Terms**

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.

**DVB-H (Digital Video Broadcasting-Handheld):** DVB-H technology combines digital video with the Internet Protocol (IP): contents are subdivided into packets using the same basic technology employed by the Internet. The use of IP technology allows the transmission of TV and radio programmes, web pages, music and video games to smartphones/PDA s.

**DWDM (Dense Wavelength Division Multiplexing):** This is a technology for multiplying and transmitting different wavelengths along a single optical fibre contemporaneously.

**EDGE (Enhanced Data for GSM Evolution):** This is a powerful technology that increases the data transmission rate of the GPRS standard from rates of 30-40 kbit/s to more than 100 kbit/s and even up to 200 kbit/s with optimal radio conditions.

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

**Exchange:** See Switch.

**Flat rate:** The rate applied by providers to users surfing the web. It is usually a fixed monthly rate for a subscription to a specific Internet Service Provider, aside from the number of connection hours to the Net.

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

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

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

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

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

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

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

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

**HSDPA (High-Speed Downlink Packet Access/UMTS Hi Speed Universal Mobile Telecommunications System):** UMTS evolution allows broadband connections up to 3.6 Mbps.

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

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

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

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

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

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

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

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

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

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

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

**ITU (International Telecommunication Union):** The worldwide policy, spectrum regulation and standardization body in telecommunication 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.

**Local Loop:** Copper wire-couple, through which the telephone connection reaches users; it is the foundation of traditional telephone lines and it is often called "last mile".

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

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

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**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.

**MGW (Media GateWay):** Junction for the connections which carry user traffic.

**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.

**MSC (Mobile Switching Center):** Executes functions such as controlling calls, switching traffic, taxation, controlling network interfaces and acts as an interface with other networks.

**MSP:** The name of a general purpose programmable switch made by Redcom Laboratories.

**Multimedia:** A service involving two or more communications media (e.g., voice, video, text, etc.) and hybrid products created through their interaction.

**Network:** An interconnected collection of elements. In a telephone network, these consist of switches connected to each other and to customer equipment. The transmission equipment may be based on fiber optic or metallic cable or point to point radio connections.

**NGN (Non-Geographic Number):** The non-geographic numbers are unique as they are by definition not associated with any particular geographic location (e.g. premium rate services, toll free, directory assistance services).

**NNI Agreements (Network Node Interface Agreements):** Contractual agreements for the interface between two public network pieces of equipment ( NNI ).

**Node:** Topological network junction, commonly a switching center or station.

**Node B (counterpart of BTS in GSM):** This is the Radio Base Station in UMTS technology which, via an antenna, sends the UMTS radio signal which creates the coverage of the cell (typically 3 for Node B). It also performs functions which are strictly associated with managing the radio connection.

**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:** Thin glass, silica or plastic wires, building the interstructure base for data transmission. An optical fiber cable contains several individual fibers, and each of them is capable of driving a signal (light impulse) at limited bandwidth. Optical fibers are usually employed for long-distance communication: they can transfer heavy data loads, and the signal reaches the recipient, protected from possible disturbances along the way. The only inconvenient are the high costs involved in the construction of an optical fiber network.

**OSS (Operations Support System):** Methods and procedures (whether mechanized or not) which directly support the daily operation of the telecommunications infrastructure.

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**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.

**Pard CDN:** Points of access to a data network realized by direct digital circuits.

**Pard CDA:** Points of access to a data network realized by direct analog circuits.

**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 single transmission path for multiple communications. The cells are then reassembled upon reaching their destination.

**Pay-Per-View or PPV:** A system by which the viewer pays to see a single program (such as a sporting event, film or concert) at the moment at which it is transmitted or broadcast.

**Pay TV:** Paid-for TV channels. To receive Pay TV or Pay-Per-View programs, a decoder must be connected to the television set, and a conditional access system.

**PCS:** Personal communications services.

**PDA (Personal Digital Assistant):** A handheld computer with a memory size up to several megabytes and a touch-sensitive screen, often using a stylus to input data. The PDA is mainly used for calendar, address book and memoranda functions, but can incorporate advanced office or multimedia functions such as voice calls, messaging, video, mp3 player, etc..

**Penetration:** The measurement of the take-up of services. As of any date, the penetration is calculated by dividing the number of subscribers by the population to which the service is available and multiplying the quotient by 100.



**Platform:** The total input, including hardware, software, operating equipment and procedures, for producing (production platform) or managing (management platform) a particular service (service platform).

**POP (Point Of Presence):** Internet provider locations for network connection, often through dial-up phone lines. When a Pop is within a specific local area, users can connect to the Internet by dialing a local phone number.

**POTS (Plain Old Telephone Service):** Refers to the basic telephony service (homes use) supplying standard, single-line telephones, fixed-line services and access to public voice telephony network. In contrast, telephone services based on digital communications lines, such as ISDN, are not POTS. The main distinctions between POTS and non-POTS services are speed and bandwidth. POTS is generally restricted to about 52 Kbps.

**PSTN (Public Switched Telephone Network):** The public telephone network delivering the basic telephone service and, in certain circumstances, more advanced services.

**RNC (Radio Network Controller counterpart of BSC in GSM):** Supervises and controls radio resources, both during the phase of setting up the call, and during the maintenance phase (for example, handover between different cells). Furthermore, it handles connectivity from and towards: Node B, MSC\*, and other RNC.

**Roaming:** A function that enables wireless subscribers to use the service on networks of operators other than the one with which they signed their initial contract.

**RoF (Radio Over Fiber):** A technology to feed antennas with digital/analogue signals over optical fiber.

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**RTG:** Is the network of the world's public circuit-switched telephone networks in much the same way that the Internet is the network of the world's public IP-based packet-switched networks.

**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.

**SMS (Short Message Service):** Short text messages than can be received and sent through GSM-network connected cellular phones. The maximum text length is 160 alpha-numerical characters.

**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.

**TDMA (Time Division Multiple Access):** A technology for digital transmission of radio signals between, for example, a mobile phone and a radio base station. TDMA breaks signals into sequential pieces of defined length, places each piece into an information conduit at specific intervals and then reconstructs the pieces at the end of the conduit.

**UMA (Unlicensed Mobile Access):** Technology that provides access to mobile services over unlicensed spectrum technologies, such as Bluetooth and IEEE 802.11 b/g. By deploying UMA technology, service providers can enable subscribers to roam and handover between cellular networks and public and private unlicensed wireless networks using dual-mode mobile handsets.

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**UMTS (Universal Mobile Telecommunication System):** Third-generation mobile communication standard. Data travel at 2Mb-per-second.

**UMTS Cells:** Geographical portion of the territory illuminated by a Node B.

**UMTS Channels:** These enable all the customers of the cell to access both the CS (Circuit Switched) services and the PS (Packet Switched) services of UMTS technology.

**Unbundling:** A process which allows telephone carriers (other than Telecom Italia) to lease the last part of the telephone loop, that is to say, the copper wire-cable, connecting Telecom Italia central station to the user's home, disconnecting the user from Telecom terminals and connecting him/her to the telephone carrier's terminals.

**Universal service:** The obligation to supply basic service to all users throughout the national territory at reasonable prices.

**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.

**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; videotext and videotelephone. Value Added Services could include also value added voice telephony services such as Freephone or Premium Rate Services.

**VDSL (Very-high-data-rate Digital Subscriber Line):** One of four DSL technologies (very high bit-rate DSL) providing data transmission up to a theoretical limit of 52 Mbit/s downstream and 12 Mbit/s upstream over a single twisted pair of wires. VDSL is capable of supporting high bandwidth applications such as HDTV. The higher limit of data rate of VDSL is limited by the distance from the exchange.

**Videotext:** A service pursuant to an ITU standard, permitting remote access to a database by telephone.

**VoIP (Voice over IP):** Transmission of voice communications over Internet Protocol (IP) data networks, such as IP-based LANs, intranets or the Internet. Many carriers offer integrated services such as voice and data over a single pipe.

**VPN (Virtual Private Network):** A network designed for a business or government agency, using the infrastructures of a carrier and providing customized services, and which operates in such a manner as to appear dedicated to the user thereof.

**WAN (Wide Area Network):** A private network that covers a wide geographic area using public telecommunications services.

**WAP (Wireless Application Protocol):** A technology which allows access to the Internet using mobile sets, even without the use of a computer.

**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.

**XDSL ((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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As of December 31, 2006, the Telecom Italia Group owned approximately 4,700 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 our continuing telecommunications operations. General purpose properties consist chiefly of offices, depots and computer centers.

The principal categories of our equipment are exchanges and transmission equipment, cable networks, base stations for cellular networks and equipment for radio communications, most of which are located throughout Italy. We also have numerous computer installations which are primarily located at the headquarters of our significant subsidiaries.

As of December 31, 2006 and 2005, property, plant and equipment owned and leased are detailed as follows:

|  | As of December 31, 2006               |              |                                      |   | As of December 31, 2005 |              |                                      |   |
|--|---------------------------------------|--------------|--------------------------------------|---|-------------------------|--------------|--------------------------------------|---|
|  | Owned                                 | Leased       | Total property, plants and equipment | % of total property, plants and equipment | Owned                   | Leased       | Total property, plants and equipment | % of total property, plants and equipment |
|  | (millions of Euro, except percentage) |              |                                      |   |                         |              |                                      |   |
| Land   | 134                                   |              | 134                                  | 0.8                                       | 155                     |              | 155                                  | 0.9                                       |
| Civil and industrial buildings                 | 598                                   | 1,417        | 2,015                                | 11.7                                      | 972                     | 1,477        | 2,449                                | 13.6                                      |
| Plant and equipment                            | 12,955                                | 1            | 12,956                               | 75.3                                      | 12,907                  | 1            | 12,908                               | 71.5                                      |
| Manufacturing and distribution equipment       | 59                                    |              | 59                                   | 0.3                                       | 72                      |              | 72                                   | 0.4                                       |
| Aircrafts and ships                            | 40                                    | 10           | 50                                   | 0.3                                       | 46                      | 14           | 60                                   | 0.3                                       |
| Other  | 1,016                                 | 47           | 1,063                                | 6.2                                       | 1,174                   | 71           | 1,245                                | 6.9                                       |
| Construction in progress and advances payments | 888                                   | 50           | 938                                  | 5.4                                       | 1,117                   | 35           | 1,152                                | 6.4                                       |
| <b>Total</b>                                   | <b>15,690</b>                         | <b>1,525</b> | <b>17,215</b>                        | <b>100.0</b>                              | <b>16,443</b>           | <b>1,598</b> | <b>18,041</b>                        | <b>100.0</b>                              |

As of December 31, 2006, we did not have liens, mortgages and pledges on real property owned.

**Real Estate Transactions**

An important element of the restructuring which we have undertaken since 2000 was to realize value on our extensive real estate portfolio.

In November 2000, we established a partnership with Beni Stabili, a leading Italian real estate operator, and Lehman Brothers to manage a significant portion of our real estate portfolio.

We contributed a going concern including an important portion of our real estate portfolio to IM.SER and subsequently sold 45% of this company to Beni Stabili and 15% to Lehman Brothers.

The real estate portfolio originally held by IM.SER consisted of 581 properties, totaling 3.7 million square meters and was composed of two parts, the Real Estate Investment Portfolio and the Real Estate Trading Portfolio :

- Real Estate Investment Portfolio , consisting of 386 properties totaling approximately 2.4 million square meters, located throughout Italy. All the properties, including buildings that contain telecommunications equipment, were leased to Old Telecom Italia at the end of 2000 under long-term lease contracts (21 plus 6 years) at market rates; and
- Real Estate Trading Portfolio , consisting of 195 properties totaling approximately 1.3 million square meters, located throughout Italy. Of these properties, the majority have been leased at market rates to Old Telecom Italia under contracts allowing for early termination by Telecom Italia.

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In May 2001, IM.SER contributed its Real Estate Trading Portfolio to Telemaco Immobiliare, a newly formed company. Following such contribution, IM.SER sold the shares of Telemaco Immobiliare to its shareholders. The shareholders of Telemaco Immobiliare at that time were Beni Stabili with a 45% stake, Telecom Italia with a 40% stake and Lehman Brothers with a 15% stake.

On May 16, 2001, Beni Stabili exercised an option to buy the Lehman Brothers stake in IM.SER, resulting in Beni Stabili holding a 60% stake in IM.SER and Old Telecom Italia a 40% stake.

Since 2002 certain additional real estate related transactions were completed.

**Tiglio Project**

Pursuant to a framework agreement signed in May 2002, among the Pirelli Group, Olivetti-Telecom Italia Group and The Morgan Stanley Real Estate Funds (through MSMC Italy Holding B.V. and POPOY Holding B.V.), certain real estate properties as well as the entities that provide real estate services to the same companies or to their subsidiaries were transferred to two new vehicle companies set up for this purpose (Tiglio I S.r.l. and Tiglio II S.r.l.).

Among the preliminary transactions for the concentration of the real estate assets in Tiglio I and Tiglio II, on October 24, 2002, the non-proportional partial spin-off of IM.SER (60% Beni Stabili and 40% Telecom Italia) was effected by which the real estate assets were contributed to the company IM SER 60 (98% Beni Stabili group and 2% Telecom Italia) and to the company EMSA Immobiliare (100% controlled by Telecom Italia) in proportion to the stakes held in IM.SER, respectively, by Beni Stabili and Telecom Italia.

Following this transaction, which came after the completion of the securitization of IM SER 60's debt and acquisition of certain tangible asset by companies in the Seat Pagine Gialle group, EMSA Immobiliare had a portfolio of 169 real estate properties.

On October 29, 2002, the first stage of the Tiglio Project was concluded, through:

- the subscription by Old Telecom Italia, simultaneously with all the other participants, to a capital increase by Tiglio I for cash, with the resulting stake in the company equaling 36.85% (in addition, at Old Telecom Italia Group level, to the 2.1% subscribed to by Seat Pagine Gialle), in proportion to the value of the assets transferred by Old Telecom Italia (and by Seat Pagine Gialle) to Tiglio I to the total assets that were taken over by Tiglio I;
- the subscription to a capital increase by Tiglio II paid for in kind by the contribution of Old Telecom Italia's Asset Management business segment with resulting stake in the company equaling 49.47%;



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- the sale directly and through the subsidiary Saiat of the investment in Telimm S.r.l. to the company MSMC Immobiliare Holding (entirely controlled by Tiglio I).

With reference to the part of the Tiglio Project regarding the optimization of the service activities, in November 2002, Telecom Italia sold its Property Management , Project Management and Agency businesses to the Pirelli & C. Real Estate group.

The above mentioned transactions gave rise to a total gross capital gain for the Telecom Italia Group of 234 million.

Finally, as agreed between the parties, December 24, 2002 marked the completion of the merger by absorption, in Tiglio I and Tiglio II, of the real estate investment holdings owned by them falling under the Tiglio Project and already 100% controlled, directly or indirectly; resulting in the optimization of the corporate structure of the two companies, in view of the successive actions to leverage the assets on the market.

In particular, the second stage of the Tiglio Project consisted of the change of asset ownership, through transfers to real estate funds, or through completion of certain other transfers. The real property has been divided into several categories (office, industrial portfolio, trading portfolio, etc.), in order to optimize Tiglio I and Tiglio II shareholders profit, and also into take account the real estate funds market features.

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Under the second stage of the Tiglio project, in 2004 the following real estate funds were placed in the market:

- **TECLA FONDO UFFICI** placement closed on March 1, 2004. The Fund consisted of a contribution on the part of Tiglio I (45.70%-owned by Telecom Italia) of a real estate portfolio including 65 properties for a total market value of approximately 926 million, to which a 15% discount was applied by virtue of their transfer en masse, in addition to a contribution of 25 million in cash. The total offer, net of indebtedness equal to 60% of the value contributed, amounted to 288 million, of which 10% was kept by Tiglio I, 2% was subscribed by Pirelli & C. Real Estate Società di Gestione del Risparmio S.p.A. as manager of the fund, while the remaining 88% was entirely placed on the market.
- **CLOE FONDO UFFICI** placed on the market on June 29, 2004. The Fund consisted of 39 properties contributed by Tiglio I for a market value equal to approximately 877 million, to which a 15% discount was applied by virtue of their transfer en masse. The total offer, net of 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 placed 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, with 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 consisted of 44 properties with a market value of approximately 742 million. The value of the Fund is approximately 261 million.
- **CLARICE LIGHT INDUSTRIAL** placement with qualified investors on December 16, 2004. The Fund consisted of 27 properties transferred by Tiglio I and 43 properties transferred by Tiglio II, for a total market value of 221 million, to which a 9% discount was applied by virtue of their transfer en masse. The contribution value was thus equal to 201 million and the value of the fund, after taking into account financial indebtedness of approximately 55% of the contribution value, was approximately 90 million. The Fund was entirely placed with European investors.
- **BERENICE FONDO UFFICI** placement closed on July 14, 2005. The Fund consisted of 54 properties transferred by five private parties, including Tiglio I (8 buildings) and Tiglio II (37 buildings), for a total market value of 860 million, to which a 13% discount was applied by virtue of their transfer en masse. The contribution value was thus equal to 750 million and the value of the fund, after taking into account financial indebtedness, was approximately 300 million. The Fund was entirely placed with Italian and European investors.

Subsequent to these transactions:

- in 2004, Tiglio I and Tiglio II proceeded to distribute cash to the shareholders in the form of a reimbursement of capital (additional paid-in capital) and the repayment of loans. For the Telecom Italia Group, total receipts were approximately 104 million, of which 79 million was from Tiglio I and 25 million from Tiglio II;
- in September 2005, Tiglio I and Tiglio II proceeded to distribute cash to the shareholders in the form of a reimbursement of capital (additional paid-in capital) for 29.7 million and 33.1 million to Telecom Italia S.p.A., respectively. Furthermore,

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Tiglio II, resolved to pay dividends and Telecom Italia S.p.A. is entitled to 11.4 million, of which 8.9 million has already been received and 2.5 million is still to be collected;

- in 2006, Tiglio I e Tiglio II distributed cash to the shareholders in the form of a reimbursement of capital (additional paid-in capital) for a total amount of approximately 31 million. Tiglio I approved a distribution of 24 million collected in full of which 23 million was Telecom Italia's share and 1 million was Telecom Italia Media's share. Tiglio II approved a distribution to Telecom Italia of 7 million, also collected in full during 2006. Furthermore, Tiglio II approved the distribution of dividends to Telecom Italia for 2 million, collected in March 2006, and also made a payment of 3 million to Telecom Italia for its share of the distribution of dividends declared in 2005 which had not

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yet been paid. Tiglio II, finally, approved the reduction in share capital and reimbursed the shareholders. Telecom Italia's share amounts to an income of 4 million which was almost entirely collected in December 2006.

**Magnum Project**

In order to optimize the physical space occupied by network equipment and to gradually free part of the buildings used for such equipment, in 2005 the Board of Directors of Telecom Italia approved the sale of more than 1,300 properties for a total amount of about 1 billion. The first part of this project was completed in 2005 and involved 867 buildings. On March 1, 2006, June 1, 2006 and on November 17, 2006, Telecom Italia S.p.A. transferred, respectively, a second tranche consisting of 348 buildings, a third tranche consisting of 116 buildings and a fourth tranche consisting of 47 buildings to the subsidiary Olivetti Multiservices ( **OMS** ), and, at the same time, the relative lease contracts were signed.

Following two Framework Agreements in December 2005 (later amended on June 21, 2006) between Telecom Italia and OMS on one hand and Pirelli & C. Real Estate and other parties on the other, aimed at transferring the assets to closed-end real estate investment funds, (namely the Raissa and Spazio Industriale funds) the following transactions took place:

- on March 29, 2006, OMS contributed a second group of 201 properties to the Raissa Fund (27 of which are under a simultaneous long-term finance leaseback) with a contribution value of 158 million and at the same time transferred the financial debt of 97 million assumed beforehand by OMS. The majority of the shares of the Raissa Fund that came from the properties contributed was sold to institutional investors headed by The Morgan Stanley Real Estate Funds. Pirelli RE has a 35% stake in the Raissa Fund under a joint venture with the same funds;
- on March 30, 2006, OMS contributed a second group of 120 properties to the Spazio Industriale Fund with a contribution value of 71 million and at the same time transferred the financial debt of 60 million assumed beforehand by OMS. The majority of the shares of the Spazio Industriale Fund that came from the properties contributed was sold to institutional investors headed by Cypress Grove International Funds. Pirelli RE has a 35% stake in the Spazio Industriale Fund under a joint venture with the same funds;
- on June 26, 2006, OMS contributed a third group of 54 properties to the Spazio Industriale Fund with a contribution value of 41 million and at the same time transferred the financial debt of 35 million assumed beforehand by OMS. The majority of the shares of the Spazio Industriale Fund that came from the properties contributed was sold to institutional investors headed by Cypress Grove International Funds;
- on June 29, 2006, OMS contributed a third group of 57 properties to the Raissa Fund (13 of which are under a simultaneous long-term finance leaseback) with a contribution value of 47 million and at the same time transferred the financial debt of 29 million assumed beforehand by OMS. The majority of the shares of the Raissa Fund that came from the properties contributed was sold to institutional investors headed by The Morgan Stanley Real Estate Funds;
- on December 14, 2006, OMS contributed a fourth group of 33 properties to the Raissa Fund (5 of which are under a simultaneous long-term finance leaseback) with a contribution value of 30 million and at the same time transferred the financial debt of 18 million assumed beforehand by OMS. The majority of the shares of the Raissa Fund that came from the properties contributed was sold to institutional investors headed by The Morgan Stanley Real Estate Funds;

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- on December 20, 2006, OMS contributed a fourth group of 7 properties to the Spazio Industriale Fund with a contribution value of 3 million and at the same time transferred the financial debt of 2 million assumed beforehand by OMS. The majority of the shares of the Spazio Industriale Fund that came from the properties contributed was sold to institutional investors headed by Cypress Grove International Funds.

Telecom Italia Group realized a gross consolidated gain of 135 million on the above-described transactions and a positive impact on the consolidated financial debt of the Group of 296 million before taxes.

With reference to the properties which came under the control of OMS following the transfer from Telecom Italia, OMS has 98 properties still to be monetized which are currently leased to the Company.

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**Item 4A. Unresolved Staff Comments**

**Item 4A. UNRESOLVED STAFF COMMENTS**

None.

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

**General Factors Affecting The Telecom Italia Group s Business**

**Item 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

*The following discussion should be read in conjunction with the Consolidated Financial Statements included elsewhere in this Annual Report. Such financial statements have been prepared in accordance with IFRS, which differ in certain material respects from U.S. GAAP. For a discussion of the principal differences between IFRS and U.S. GAAP as they relate to Telecom Italia, see Note 46 Reconciliation of IFRS as Adopted by the EU to U.S. GAAP of the Notes to the Consolidated Financial Statements included elsewhere herein.*

**5.1 GENERAL FACTORS AFFECTING THE TELECOM ITALIA GROUP S BUSINESS**

**5.1.1 THE ITALIAN MARKET FOR TELECOMMUNICATIONS SERVICES**

In 2006, based on external sources and internal estimates, the Italian telecommunications market grew by around 3%. As a whole, this market has shown:

- a growing process of substitution between fixed and mobile components in the traditional voice segment;
- broadband penetration as a strong key growth driver in both the fixed and mobile market;
- an overall steady growth in consumption patterns.

Italy is one of the European countries with both the highest mobile penetration rate and highest absolute number of subscribers. Italy is also a leader among European countries in terms of availability and spread of third generation mobile services.

Broadband penetration in the fixed market reached around 37% on total fixed access with a strong growth of VoIP penetration. VoIP customers in the Italian market exceeded 1 million at the end of 2006.

Over the next three years, the market composed of telecommunication services, of **ICT** (Information Communication Technology) services and of Pay-TV is expected to continue to grow by approximately 4% annually (compound average growth rate ( **CAGR** ) 2006-2009) according to our estimates, with a stable Core TLC market and strong growth in new business areas (ICT and IPTV) enabled by innovative technologies and platforms.

The total Italian Core TLC retail market is expected to grow by approximately 1.6% annually (CAGR 2006-2009) according to our estimates.

In the short term (2007-2008) the Italian Core TLC market trends for revenues will be negatively influenced by regulatory actions (elimination of top-up fees Bersani Decree (see: Note 44-Events subsequent to December 31, 2006 of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report), and international roaming costs reduction) principally in the mobile market.

As in recent years, the growth in demand for telecommunications carrier services is expected to be driven primarily by the development of broadband and fixed data services and by mobile telephone services.

In the Italian Wireline Retail market:

- traditional voice services value as a whole is in the process of continuous reduction due to a slow decline of market access lines, fixed to mobile migration and partial cannibalization by alternative communication solutions (e-mail, messaging, chat) on traffic and to reduction in tariffs relating to mobile termination, partially compensated in the coming years by the introduction of flat double play and triple play bundle offers that will contribute to retaining customers in the fixed network;
- the Internet segment will continue to grow driven by broadband development that enables dual and triple play services; there will be a strong development of Voice over IP and Value Added Internet related services;
- the fixed data segment will complete the migration from traditional to broadband data transmission solutions and will be characterized by a slight decrease due to the renewed pressure on prices of Data transmission solutions to Top Clients compensated by the growth of ICT solutions.



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

**General Factors Affecting The Telecom Italia Group s Business**

In the Italian Wireless Retail market:

- the Italian Mobile Services market growth will be negatively influenced in the short term (2007-2008) by regulatory actions (elimination of top-up fees Bersani Decree, and international roaming costs reduction). Apart from these regulatory actions, the Italian Mobile market trend will be driven by:

a decreasing contribution of voice revenues to market growth due to price pressure caused by the development of flat offers and mobile virtual operators. Generally, lines, volumes and usage will continue to grow driven by fixed to mobile substitution;

strong value added services growth (such as multimedia messages, browsing, contents and interactive services) driven by migration to UMTS and broadband, innovative handsets penetration and increasing bandwidth availability; web browsing will become a key driver of market development;

- the handsets market is expected to grow slightly, but is now a substitution market from GSM/GPRS handsets to innovative UMTS/HSDPA/DVBH handsets.

Telecom Italia s market (ICT and PayTV) is expected to grow due to:

- increased broadband penetration and bandwidth availability that fosters the adoption, by a large number of business customers, of Internet-enabled ICT applications and services previously available only locally;
- progressive network upgrade in terms of bandwidth availability and IPTV platforms evolution will foster the developments of IPTV offers that let Telco operators catch the opportunity to enter in the growing Pay-TV Italian market.

**5.1.2 COMPETITION**

We face domestic competition in all of our businesses. For details please see Item 4. Information on the Telecom Italia Group 4.1 Business 4.1.7 Updated Strategy and Item 4. Information on the Telecom Italia Group 4.2 Business Units 4.2.8 Competition .

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

**Significant Trends Impacting Our Core Businesses**

**5.2 SIGNIFICANT TRENDS IMPACTING OUR CORE BUSINESSES**

As described above under 5.1 General Factors Affecting the Telecom Italia Group's Business, management has identified the following key trends that have, and will continue to have, an impact in our two main business areas.

- convergence of services, such as fixed and mobile voice bundled offers, dual mode access (UMA), integrated (fixed and mobile) access to messaging and content;
- achievement of synergies from fixed/mobile integration; and
- impact of Bersani law, self-regulation of International roaming charges and reduction of termination charges. For details see: Note 44 Events subsequent to December 31, 2006 4.2.3 Domestic Mobile General information on services in Italy Regulation Special Status of operators having significant market power .

In addition, other key trends should continue to have a significant impact:

*Wireline*

- Continuing defense of core traffic and access businesses with stabilization of traffic market share.
- Strong development of new value added services (Voice VAS and Web Services) content and handsets contributing to a stabilization in revenues.
- Strong growth of Italian broadband market with significant increase of the Wireline broadband access portfolio.
- Strong growth of PayTV market and penetration of IPTV services.
- Growth of ICT Market, and in particular of IT managed services to business customers, both infrastructure based services (development and management of activities related to IT systems, platforms and applications) and people based services (technical support, consulting and training activities more related to business processes than to specific IT systems). Ability of increased broadband penetration and bandwidth availability to effectively foster the adoption of internet-enabled IT applications by business customers, and relevant effort towards ICT portfolio enrichment and partnership development in order to increase Telecom Italia's market share on the ICT market.
- Consolidation of the European Broadband Project with growth of revenues and customer base in selected European countries.

*Mobile*

- Continuing strong competition in the Italian market.
- Stabilization/Growth of market share.
- Significant growth in value added services driven by the introduction of new technologies/new handsets and by a higher customer demand.
- Profitable growth in the Brazilian market.

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

**Critical Accounting Policies And Estimates**

**5.3 CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

Our discussion and analysis of our financial condition and results of operations is based upon our Consolidated Financial Statements, which have been prepared in accordance with IFRS and which, as described in Note 46 Reconciliation of IFRS as adopted by the EU to U.S. GAAP of the Notes to the Consolidated Financial Statements included elsewhere herein, differ in certain material respects from U.S. GAAP. Our reported financial condition and results of operations as reported under IFRS and in our reconciled U.S. GAAP financial information are based on the application of the accounting methods which involve the use of assumptions and estimates that underlay the preparation of our financial statements. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily available. Actual results may differ from these estimates under different assumptions or conditions.

Since our selection and application of accounting policies involve judgments and other assumptions affecting the application of those policies, reported results are sensitive to changes in conditions or assumptions of management and these are factors to be considered when reading our Consolidated Financial Statements. We believe the critical accounting policies described below involve the most significant assumptions and estimates used in the preparation of our Consolidated Financial Statements under IFRS and in our reconciled U.S. GAAP information.

**5.3.1 REVENUE RECOGNITION**

Revenues are recognized to the extent that it is probable that the economic benefits will flow to the Group and the revenues can be reliably measured. Revenues are stated net of discounts, allowances, and returns. Traffic revenues from interconnections and roaming are reported gross of the amounts due to other TLC operators.

In particular, our primary revenue streams consist of fixed line telecommunication services, mobile telecommunication services, the sale of products including primarily telecommunication (both fixed and mobile) equipment and office products, and Internet access and related services.

Revenues related to fixed line and mobile telecommunication services, principally network access, long distance calls, local and wireless airtime usage, are recognized when the services are provided based on the actual minutes of traffic provided and the contracted fee schedule with the customer.

Revenues from the activation of telephone services, as well as the related costs, are deferred over the expected duration of the relationship with the customer (mainly 8 years for retail customers and 3 years for wholesale customers). The estimate of the duration of the customer relationship is based on historical turnover analysis. Revision of such estimates may lead to differences in the amount and timing of the recognition of revenues and expenses.

Revenues from prepaid traffic are recorded on the basis of the minutes used at the contract price per minute. Moreover, when customers recharge their prepaid cards they pay a fixed amount as Recharging income. The revenues from Recharging income and the relative costs (amounts paid to resellers, banks and other parties), with the latter not exceeding the Recharging income, are deferred over the period between two subsequent recharges (about one month).

Furthermore, we have multiple element arrangements mainly in fixed and mobile business segments.

As allowed by IAS 8 (*Accounting Policies Changes in Accounting Estimates and Errors*), paragraph 12, to account for multiple element arrangements we have adopted the provisions of the Emerging Issues Task Force Issue No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables* ( EITF 00-21 ) for multiple-element revenue arrangements entered into after December 31, 2003. EITF 00-21 requires that arrangements involving the delivery of bundled products or services be separated into individual component deliverables, each with its own separate earnings process. Revenue relating to the bundled contract is allocated among the different deliverables, based on their relative fair values (the relative fair value of each of the component deliverables to the aggregated relative fair value of the bundled deliverables). The determination of fair values in the fixed and mobile business is complex, because some of the components are price-sensitive and, thus, volatile in a competitive marketplace. Revisions to our estimates of these relative fair values may significantly affect the allocation of sales values among the different deliverables, affecting our future operating results.

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**Critical Accounting Policies And Estimates**

**5.3.2 ALLOWANCE FOR DOUBTFUL ACCOUNTS**

Management maintains an allowance for doubtful accounts to account for estimated losses resulting from the inability of our customers to make required payments. Management bases its estimates on the ageing of our accounts receivable balances and our historical write-off experience with similar receivables, customer credit-worthiness and changes in our customer payment history when evaluating the adequacy of our allowance for doubtful accounts. If the financial condition of our customers were to deteriorate, our actual write-offs might be higher than we estimate.

**5.3.3 ACCOUNTING FOR TANGIBLE AND INTANGIBLE NON-CURRENT ASSETS**

Accounting for tangible and intangible non-current assets involves the use of estimates for determining fair value at the acquisition date in the case of assets acquired in a business combination. The expected useful lives of assets with a finite life must be estimated. The determination of the fair values of assets, as well as the useful lives of the assets is based on management's judgment. Changes in the economic conditions of the markets in which we operate, technology and competitive forces could significantly affect the estimated useful lives of these assets and may lead to a difference in the timing and amount of depreciation and amortization expense.

**5.3.4 ACQUISITION ACCOUNTING, GOODWILL AND PURCHASE PRICE ALLOCATION**

We have entered into certain acquisitions and in the future may make further acquisitions. The calculation of the purchase price, and the subsequent allocation of that purchase price to the fair value of the assets acquired and liabilities assumed, is critical due to the long term impact on the statement of income.

Under IFRS and U.S. GAAP, we are required to perform a purchase price allocation and, consequently, as part of that allocation, all consideration, including the fair value of exchanged shares, shall be valued. When equity instruments are issued as part of the consideration, under IFRS we measure them at their fair value as of the date of exchange whereas under U.S. GAAP we measure them by taking into account the market price for a reasonable period before and after the date the terms of the acquisition are agreed to and announced.

The purchase price is then allocated to the fair value of the assets acquired and liabilities assumed.

The purchase price allocation requires that all assets, liabilities and contingent liabilities be valued and that significant estimates be made. A change in any of these estimates or judgments could change the amount to be allocated to a particular intangible or tangible asset. The resulting change in the purchase price allocation to non-goodwill assets or liabilities has a direct impact on the final amount of the purchase price that cannot be allocated to a particular asset (i.e., goodwill).

If actual results differ from these estimates, or we adjust the estimated useful economic lives in future periods, operating results could be significantly affected by these estimates and judgments which involve:

- the definition of the purchase price;
- the identification of the assets acquired and liabilities assumed in the acquisition;
- the valuation of these assets and liabilities in the purchase price allocation; and
- the assessment of whether selected assets have a finite or indefinite life.

These could have a significant impact on both the level of total goodwill and ultimately on the statement of income.

#### **5.3.5 ACCOUNTING FOR TRANSACTIONS ON INTERESTS IN GROUP COMPANIES**

We have entered into certain acquisitions and sales of interests in Group companies, and in the future we may make further similar transactions.

With regard to such transactions, under IFRS, in the absence of a Standard or a specific Interpretation on the matter and referring to IAS 8 (*Accounting policies, changes in accounting estimates and errors*), we have applied the following accounting treatments, identifying two types of transactions:

- *acquisition/sale of interests in companies already controlled:* in the case of acquisitions, the Group pays the minority interests in cash or with new shares and, at the same time, eliminates the relative

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share of the minority interest and records Goodwill equal to the excess of the acquisition cost over the carrying amount of the assets and liabilities acquired. In the case of sales, the difference between the sales amount and the corresponding carrying amount on consolidation is recognized in the statement of income (*Parent entity extension method*);

- *transactions among companies under common control which result in a change in the percentage of ownership:* the interests transferred remain recorded at historical cost and the gain or loss on the transfer is eliminated in full. The minority interests which do not directly take part in the transaction are adjusted to reflect the change in the respective share of equity with a corresponding opposite effect on the equity attributable to the equity holders of the Parent without recognition of any goodwill and therefore without generating any impact on net income or total equity.

Under U.S. GAAP, such transactions are accounted for under the purchase method and, consequently, goodwill is calculated as the difference between the consideration paid and the proportionate share of the fair value of net assets acquired at the date of acquisition.

Therefore, we are required to perform a purchase price allocation and, consequently, as part of that allocation, all consideration shall be valued. When equity instruments are issued as part of the consideration, under U.S. GAAP we measure them by taking into account the market price for a reasonable period before and after the date the terms of the acquisition are agreed to and announced.

The treatment of purchase price allocation is also affected by the considerations expressed in the last three paragraphs under 5.3.4 Acquisition Accounting, Goodwill and Purchase Price Allocation above.

**5.3.6 IMPAIRMENT OF ASSETS**

The determination of impairments of tangible and intangible assets involves the use of estimates that include, but are not limited to, the cause, timing and amount of the impairment.

**Assets with a finite life.** For IFRS purposes, during the year, the Group assesses whether there are any indicators that tangible and intangible assets with a finite life may have been impaired. If such indicators exist, the Group estimates if the carrying amount of an asset, a group of assets or a cash-generating unit exceeds the recoverable amount. Both internal and external sources of information are used to determine if indicators of impairment exist. Internal sources considered include obsolescence or physical damage, any significant changes in the use of the asset and the economic performance of the asset compared to estimated performance. External sources considered include market value of the asset, negative changes in technology, markets or laws, increases in market interest rates and the cost of capital used to evaluate investments, and the comparison of the carrying amount of net assets of the Group to market capitalization.

**Intangible assets with an indefinite life.** Intangible assets with an indefinite life, including goodwill, are tested for impairment at least annually to assess the recoverable amount of the asset. The test is conducted in conjunction with the planning process of the



Group, near the end of every year. Goodwill acquired and allocated during the year is tested for impairment before the end of the year in which the acquisition and allocation took place. To test for impairment, goodwill is allocated, at the date of acquisition, to each of the cash-generating units or groups of cash-generating units that is expected to benefit from the acquisition. Allocation is made to the lowest level at which goodwill is monitored for management purposes and that lowest level is not larger than the business segment determined in accordance with IAS 14 (*Segment Reporting*).

Under IFRS, the recoverable amount of an asset is the higher of fair value less costs to sell and its value in use. In assessing the value in use, the pre-tax estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

The identification of impairment indicators, the estimation of future cash flows and the determination of fair values of assets, groups of assets (or cash-generating units) require management to make significant judgments concerning the identification and validation of impairment indicators, expected cash flows, applicable discount rates, useful lives and residual values. These estimates can have a material impact on fair value and the amount of any write-downs.

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If the carrying amount of a cash-generating unit (or group of units) exceeds the recoverable amount, an impairment loss is recognized in the statement of income. The impairment loss is first recognized as a deduction of the carrying amount of goodwill allocated to the cash-generating unit (or group of cash-generating units) and only then to the carrying amount of the other assets of the cash-generating unit in proportion to their carrying amount up to the recoverable amount of the assets.

The determination of the recoverable amount of a cash-generating unit involves the use of estimates by management.

When the conditions which led to the recognition of an impairment loss on assets cease to exist or have been mitigated, the carrying amount of the asset other than goodwill, or cash-generating unit, is increased to the revised estimate of its recoverable amount, but not in excess of the carrying amount that would have been recorded had no impairment loss been recognized and such reversal is recognized as income immediately.

Under U.S. GAAP, in order to assess impairment of property, plant and equipment and amortizing intangible assets, we apply the guidance outlined in SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. If, based on the preceding discussion, management has concluded that impairment indicators exist, we will initially review for possible impairment by assessing the undiscounted cash flows expected to be derived from the asset or group of assets, comparing the lowest level of total expected undiscounted cash flow to the carrying value. If the carrying value of the asset or the group of assets exceeds the sum of the undiscounted cash flows, impairment is considered to exist. An impairment charge is assessed by comparing the assets fair value to the carrying value. Fair value can be calculated by a number of different approaches, including discounted cash flow, comparables, market valuations or quoted market prices. The process and steps required to assess the possible impairments of assets, including the identification of possible impairment indicators, assessing undiscounted cash flows, selecting the appropriate discount rate, the calculation of the weighted average cost of capital and the discounts or premiums inherent in market prices require 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.

Furthermore, for purposes of our U.S. GAAP reporting, in order to assess impairment of intangible assets with an indefinite life, we use the requirements of SFAS 142, *Goodwill and Other Intangible Assets*, and as a result we do not amortize goodwill and indefinite lived intangible assets (likewise under IFRS). SFAS 142 requires that goodwill be tested for impairment at least annually (and between annual tests when certain triggering events occur) using a two-step methodology. The first step screens for triggering events indicating potential impairment at the reporting unit level, while the second step measures the impairment, if any. Under U.S. GAAP, the quoted market price of an asset or other valuation techniques, including discounted cash flow, comparables, etc., are acceptable valuation methodologies to assess fair value. The selection of the various assumptions that are necessary to arrive at the fair value of a reporting unit, including the assumptions used in the underlying business plans or targets, requires substantial management judgment and discretion.

Subsequent reversals of recognized impairment losses on goodwill and other indefinite lived intangible assets are not permitted by SFAS 142.

**5.3.7 FINANCIAL ASSETS**

Financial assets include, in particular, investments mainly in telecommunications companies that are principally engaged in the mobile, fixed-line network, Internet and data communications businesses, some of which are publicly traded and have highly volatile share prices. Generally, an impairment charge is recorded, in accordance with IFRS, when an investment's carrying amount exceeds the present value of its estimated future cash flows, and, in accordance with U.S. GAAP, when a decline in fair value is considered to be other than temporary. The calculation of the present value of estimated future cash flows and the determination of whether an impairment is other than temporary involve judgments and relies heavily on assessments by management regarding the future development and prospects of the investee company. In determining value, quoted market prices are used, if available, or other valuation methodologies. To determine whether an impairment is other than temporary, we consider the ability and intent to hold the investment for a reasonable period of time to ascertain whether a forecasted recovery of fair value exceeds the carrying amount, including an assessment of factors such as, the length of time and magnitude of the excess of carrying value over market value, the forecasted results of the investee company, the regional economic environment and state of the industry. Future adverse changes in

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market conditions, particularly a downturn in the telecommunications industry, or poor operating results could result in losses or an inability to recover the carrying amount of the investment, which could result in impairment charges.

**5.3.8 DERIVATIVES**

Telecom Italia enters into several different types of derivative contracts in order to adjust and manage the various cash flows associated with foreign currency and interest rate exposures. Under IFRS, the changes in the fair value of instruments which do not qualify for hedge accounting, fair value hedges and ineffective portion of cash flow hedges are recognized in the statement of income in the period of change. The gain or loss on the effective portion of qualifying cash flow hedges is reported in Other Comprehensive Income. The assessment of the fair value of a derivative contract requires the use of quoted market prices, banker price quotations, price quotations for similar instruments traded in different markets and, where applicable, pricing models. Pricing models and their underlying assumptions impact the amount and timing of unrealized gains and losses recognized. The Group relies on these pricing models when external fair values are unavailable. The estimates regarding future prices require estimating several factors, including interest rates, currency values and cash flows. Prices realized in the future could differ from these estimates, therefore producing different financial results.

**5.3.9 EMPLOYEE SEVERANCE INDEMNITIES**

Employee severance indemnities (or *Trattamento di Fine Rapporto TFR*) are a form of post employment benefits and, both under IFRS and U.S. GAAP, are classified and accounted for as a defined benefit plan. The obligation for employee severance indemnities is determined in accordance with actuarial methods, which rely on assumptions including discount rates, services periods, future salary increases and life expectancies.

In the event that changes in assumptions are required, with respect to these assumptions the future amounts of the post employment benefit costs may be materially affected.

**5.3.10 PROVISIONS AND CONTINGENT LIABILITIES**

The Group exercises considerable judgment in determining our exposure to and recognizing provisions for contingent liabilities related to pending litigations or other outstanding claims subject to negotiated settlement, mediation, arbitration or government regulation as well as other contingent liabilities.

Judgment is necessary in assessing the likelihood that a pending claim will succeed or a liability will arise and to quantify the possible range of the final settlement. Provisions are recorded for liabilities when losses are considered probable and can be reasonably estimated. Because of the inherent uncertainties in making such judgments, actual losses may be different from the originally estimated provision. Significant estimates are involved in the determination of provisions related to taxes, environmental liabilities, our workforce reduction initiative and litigation risks. These estimates are subject to change as new information becomes

available, primarily with the support of internal specialists or outside consultants, such as actuaries or legal counsel. Adjustments to loss provisions may significantly affect future operating results.

### **5.3.11 INCOME TAXES**

The Group calculates income taxes in each of the tax jurisdictions in which it operates. This process involves a jurisdiction-by-jurisdiction calculation of the current tax charge and an assessment of temporary differences resulting from the different treatment of certain items for IFRS consolidated financial and tax reporting purposes. Temporary differences result in the recognition of deferred tax assets or liabilities in the consolidated financial statements. Deferred tax assets are recognized to the extent that their realization is probable. The realization of deferred tax assets depends, among other things, on the company's ability to generate sufficient taxable income in future years and the reversal of temporary liabilities, taking into account any restrictions on the carryforward of tax losses. Various factors are used to assess the probability of the future realization of deferred tax assets, including future reversals of existing taxable temporary differences, past operating results, operational plans, loss-carryforward periods, and tax planning strategies. If actual results differ from these estimates or, if these estimates must be adjusted in future periods, the financial position, results of operations and cash flows may be affected. In the event of a change in the assessment of future utilization of deferred tax assets, the recognized deferred tax assets must be increased or decreased, as the case may be, and the consequent effects recognized in the statement of income.

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**Adoption Of International Financial Reporting Standards**

**5.4 ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARDS**

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

For the purposes of these Financial Statements there are no differences between IFRS issued by IASB and IFRS adopted by the EU.

The differences arising from the application of IFRS compared to Italian GAAP as well as the choices made by Telecom Italia among the accounting options provided by IFRS are described in Note 42 Transition to International Financial Reporting Standards (IFRS) of the Notes to the Consolidated Financial Statements included in the 2005 Form 20-F of Telecom Italia.

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**Results Of Operations For The Three Years Ended December 31, 2006**

**5.5 RESULTS OF OPERATIONS FOR THE THREE YEARS ENDED DECEMBER 31, 2006**

**5.5.1 REORGANIZATION OF BUSINESS**

The Telecom Italia businesses at December 31, 2006 are organized on the basis of the following Business Units or Corporate Functions:

- **Operations**, which is responsible for the management and development of fixed and mobile telecommunications and Internet services. Operations, for reporting purposes, is divided into:

**Wireline**, On a national level, the Wireline Business Unit operates as the consolidated market leader of wireline telephone and data services for final customers (retail) and other operators (wholesale). On an international level, Wireline develops fiber optic networks for wholesale customers (in Europe, in the Mediterranean area and in South America) and also offers innovative broadband services in France, Germany and The Netherlands.

**Domestic Mobile**, which operates in the sector of domestic mobile telecommunications.

**Brazil Mobile**, which operates in the sector of mobile telecommunications in Brazil.

- **Business Units** which are responsible for the development of the following businesses:

**Media**, which operates in the area of journalistic information, TV production, TV and web content offerings.

**Olivetti**, which operates in the Office Products Division in the sector of ink-jet products for the office, digital printing systems and the development and production of products associated with silicon technology (ink-jet print heads and MEMS), and also specialized applications for the banking field and commerce and information systems for gaming and lotteries. The reference market of the Business Unit is focused mainly in Europe and Asia.

For a complete description of these businesses, see Item 4. Information on the Telecom Italia Group 4.2 Business Units . For purposes of the following discussion selected financial data of each Business Unit has been provided for 2006, 2005 and 2004, and consistent with the structure of each Business Unit at December 31, 2006.

**5.5.2 NON-GAAP FINANCIAL MEASURES**

In this Annual Report on Form 20-F, in addition to figures presented in accordance with IFRS, we disclose figures derived from IFRS that are non-GAAP financial measures ( **Non-GAAP Measures** ). Such financial data is considered Non-GAAP financial

measures as defined in Item 10 of Regulation S-K under the 1934 Act.

As described in more detail below, such financial data is presented as additional information for Telecom Italia's investors and should not be considered as substitutes for or confused with economic and financial IFRS measures.

In this Annual Report the only Non-GAAP Measures utilized relates to Net Financial Debt.

**Net Financial Debt** is a Non-GAAP financial measure as defined in Item 10 of Regulation S-K under the 1934 Act, but is widely used in Italy by financial institutions to assess liquidity and the adequacy of a company's financial structure. We believe that Net Financial Debt provides an accurate indicator of our ability to meet our financial obligations, represented by gross debt, by our available liquidity, represented by the other items shown in the reconciliation table. Net Financial Debt allows us to show investors the trend in our net financial condition over the periods presented. The limitation on the use of Net Financial Debt is that it effectively assumes that gross debt can be reduced by our cash and other liquid assets. In fact, it is unlikely that we would use all of our liquid assets to reduce our gross debt all at once, as such assets must also be available to pay employees, suppliers, and taxes, and to meet other operating needs and capital expenditure requirements. Net Financial Debt and its ratio to equity (including Minority Interests), or leverage, are used to evaluate our financial structure in terms of sufficiency and cost of capital, level of debt, debt rating and funding cost, and whether our financial structure is adequate to achieve our business plan and our financial targets (which include our debt ratio, or Net Financial Debt divided by net invested capital, the latter meaning net assets excluding Net Financial Debt). Our management believes that our financial structure is sufficient to achieve our business plan and financial targets. Our management monitors the Net Financial Debt and leverage or similar measures as reported by other



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telecommunications operators in Italy and outside Italy, and by other major listed companies in Italy, in order to assess our liquidity and financial structure relative to such companies. We also monitor the trends in our Net Financial Debt and leverage in order to optimize the use of internally generated funds versus funds from third parties. Net Financial Debt is reported in our Italian Annual Report to shareholders and is used in presentations to investors and analysts. Net Financial Debt is calculated as follows:

|  | As of<br>December 31, |               |
|--|-----------------------|---------------|
|  | 2006                  | 2005          |
| (millions of Euro)   |                       |               |
| <b>GROSS FINANCIAL DEBT</b>  |                       |               |
| <b>Non-current financial liabilities (Long-term debt)</b>  |                       |               |
| Financial payables   | 38,842                | 40,252        |
| Finance lease liabilities  | 1,847                 | 1,894         |
| Other financial liabilities  | 114                   |               |
|  | <b>40,803</b>         | <b>42,146</b> |
| <b>Current financial liabilities (Short-term debt), excluding financial liabilities relating to discontinued operations/assets held for sale</b> |                       |               |
| Financial payables   | 5,374                 | 9,572         |
| Finance lease liabilities  | 269                   | 234           |
| Other financial liabilities  | 10                    | 6             |
|  | <b>5,653</b>          | <b>9,812</b>  |
| <b>Financial liabilities relating to discontinued operations/assets held for sale</b>  |                       | <b>143</b>    |
| <b>TOTAL GROSS FINANCIAL DEBT (A)</b>  | <b>46,456</b>         | <b>52,101</b> |
| <b>FINANCIAL ASSETS</b>  |                       |               |
| <b>Non-current financial assets</b>  |                       |               |
| Securities other than investments  | 12                    | 8             |
| Financial receivables and other non-current financial assets   | 679                   | 988           |
|  | <b>691</b>            | <b>996</b>    |
| <b>Current financial assets, excluding financial assets relating to discontinued operations/assets held for sale</b>                             |                       |               |
| Securities   | 812                   | 378           |
| Financial receivables and other current financial assets   | 433                   | 509           |
| Cash and cash equivalents  | 7,219                 | 10,323        |
|  | <b>8,464</b>          | <b>11,210</b> |
| <b>Financial assets relating to discontinued operations/assets held for sale</b>   |                       | <b>37</b>     |
| <b>TOTAL FINANCIAL ASSETS (B)</b>  | <b>9,155</b>          | <b>12,243</b> |

|                                 |               |               |
|---------------------------------|---------------|---------------|
| <b>NET FINANCIAL DEBT (A-B)</b> | <b>37,301</b> | <b>39,858</b> |
|---------------------------------|---------------|---------------|

### 5.5.3 OVERVIEW OF 2006 RESULTS OF OPERATIONS

Regarding our core Italian domestic activities we achieved the following:

- in Wireline, during 2006, our traffic packages and retention strategies limited revenue losses while our market share on traffic volumes remained stable: our market share on traffic volumes at December 31, 2006 was 71.9% compared with 72.3% at December 31, 2005. 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;
- in Domestic Mobile, total traffic volumes increased by 1.8% in terms of minutes and revenues increased by 1.3% in 2006 compared to 2005 ( 10,210 million in 2006 against 10,076 million in 2005). The growth in revenue was mainly attributable to the increase in outgoing voice and the higher impact of VAS revenues and was achieved in spite of decline in incoming voice due to regulatory price termination cut.

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In both our core domestic and international markets our strategy remains to focus our investment on exploiting growth opportunities. In the domestic market our focus has been on value added services and internationally on markets which we consider to have the most potential for growth mobile telecommunications in Brazil and broadband in selected European markets.

**Innovative offering:**

- the Wireline Business Unit is focused on converting its customers from traditional to innovative technologies to enlarge IP services and applications. The Wireline Business Unit is expanding its penetration in the retail broadband market through ADSL connections offered to the consumer and SOHO (Small Office Home Office) markets with a number of different branded packages (e.g. Alice, Alice Business). The company continues to have significant success in Italy with approximately 6.8 million broadband accesses sold to the retail and the wholesale market at the end of 2006 (approximately 5.7 million at December 31, 2005);
- Domestic Mobile revenues from VAS ( 1,649 million in 2006) increased by 10.2% compared to 2005. Due to the continuing introduction of new services and the success of interactive VAS, the VAS business grew significantly with its revenues representing 17.5% of service revenues, compared to 16.0% in 2005.

**International markets:**

- in September 2006, we expanded the activities of the International Broadband project in Europe by reaching a preliminary agreement for the acquisition of AOL Germany's Internet access business from Time Warner. This transaction closed on February 28, 2007. Telecom Italia continued to organically expand its customer base, and as of December 31, 2006, there were approximately 1.9 million contracts for broadband access outside Italy (1.3 million as of December 31, 2005);
- we continued to consolidate our role in Brazil during 2006. As of December 31, 2006 we had approximately 25.4 million total managed lines in our Brazilian subsidiaries and Tim Brasil consolidated its position as the second operator in the Brazilian mobile market with a 25.4% Market share, reducing the gap from first operator Vivo to less than 4 percentage points.

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The following table sets forth statement of income in accordance with IFRS for the years ended December 31, 2006, 2005 and 2004.

|  | Year ended December 31, |               |               |
|--|-------------------------|---------------|---------------|
|  | 2006                    | 2005          | 2004          |
| (millions of Euro)   |                         |               |               |
| <b>Statement of Income Data in accordance with IFRS:</b>   |                         |               |               |
| Revenues   | 31,275                  | 29,919        | 28,292        |
| Other income   | 606                     | 678           | 1,099         |
| <b>Total operating revenues and other income</b>   | <b>31,881</b>           | <b>30,597</b> | <b>29,391</b> |
| Purchases of materials and external services   | (14,191)                | (12,937)      | (11,812)      |
| Personnel costs  | (3,801)                 | (4,142)       | (3,852)       |
| Other operating expenses   | (1,543)                 | (1,468)       | (1,603)       |
| Changes in inventories   | 8                       | (4)           | 27            |
| Capitalized internal construction costs  | 496                     | 471           | 713           |
| Depreciation and amortization  | (5,487)                 | (5,232)       | (4,808)       |
| Gains (losses) on disposals of non-current assets (1)  | 95                      | 242           | (9)           |
| Impairment reversals (losses) on non-current assets  | (21)                    | (28)          | (444)         |
| <b>Operating income</b>  | <b>7,437</b>            | <b>7,499</b>  | <b>7,603</b>  |
| Share of profits (losses) of associates and joint ventures accounted for using the equity method | 51                      | 23            | (5)           |
| Financial income   | 3,041                   | 3,144         | 2,224         |
| Financial expenses   | (5,014)                 | (5,131)       | (4,216)       |
| <b>Income from continuing operations before taxes</b>  | <b>5,515</b>            | <b>5,535</b>  | <b>5,606</b>  |
| Income taxes   | (2,519)                 | (2,395)       | (2,654)       |
| <b>Net income from continuing operations</b>   | <b>2,996</b>            | <b>3,140</b>  | <b>2,952</b>  |
| Net income (loss) from discontinued operations/assets held for sale                              | 7                       | 550           | (118)         |
| <b>Net income for the year</b>   | <b>3,003</b>            | <b>3,690</b>  | <b>2,834</b>  |
| <i>Of which:</i>   |                         |               |               |
| • Net income attributable to equity holders of the Parent  | 3,014                   | 3,216         | 1,815         |
| • Net income (loss) attributable to Minority Interests   | (11)                    | 474           | 1,019         |

(1) Excludes capital gains/losses realized on disposals of investments classified as discontinued operations/assets held for sale and investments other than in subsidiaries.

**5.5.4 BUSINESS UNIT FINANCIAL DATA**

The table below sets forth revenues, operating income (loss), capital expenditures and number of employees by Business Units, for the periods indicated:

|  |         | Wireline<br>(1) | Domestic<br>Mobile | Brazil<br>Mobile | Media | Olivetti | Other<br>activities<br>(1)(2) | Adjustments<br>and<br>eliminations | Consolidated<br>Total |
|--|---------|-----------------|--------------------|------------------|-------|----------|-------------------------------|------------------------------------|-----------------------|
| (millions of Euro, except number of employees) |         |                 |                    |                  |       |          |                               |                                    |                       |
| Revenues(3)                                    | 2006    | 17,795          | 10,210             | 3,964            | 207   | 440      | 1,563                         | (2,904)                            | 31,275                |
|  | 2005(4) | 17,834          | 10,076             | 2,900            | 180   | 452      | 1,321                         | (2,844)                            | 29,919                |
|  | 2004(4) | 17,508          | 9,923              | 1,800            | 168   | 590      | 1,289                         | (2,986)                            | 28,292                |
| Operating income (loss)                        | 2006    | 4,396           | 3,742              | 21               | (137) | (50)     | (582)                         | 47                                 | 7,437                 |
|  | 2005(4) | 4,488           | 3,856              | (190)            | (130) | (38)     | (547)                         | 60                                 | 7,499                 |
|  | 2004(4) | 4,709           | 4,010              | (137)            | (93)  | 17       | (692)                         | (211)                              | 7,603                 |
| Capital expenditures                           | 2006    | 3,002           | 1,146              | 699              | 85    | 10       | 200                           | (28)                               | 5,114                 |
|  | 2005(4) | 2,823           | 1,276              | 842              | 65    | 19       | 156                           | (8)                                | 5,173                 |
|  | 2004(4) | 2,449           | 1,469              | 817              | 39    | 15       | 213                           |                                    | 5,002                 |
| Number of employees at<br>year-end(5)          | 2006    | 55,705          | 11,218             | 9,531            | 919   | 1,428    | 4,408                         |                                    | 83,209                |
|  | 2005(4) | 56,987          | 11,720             | 9,043            | 886   | 1,750    | 5,098                         |                                    | 85,484                |
|  | 2004(4) | 55,833          | 11,767             | 6,967            | 1,077 | 2,109    | 4,867                         |                                    | 82,620                |

(1) As a result of the new organizational structure of the Group approved on October 5, 2005 (the so-called **One Company Model**), the activities of the Innovation & Engineering Services business segment of Telecom Italia (ex-TILAB segment of Telecom Italia, previously included in Other activities) were transferred to the Wireline Business Unit; therefore, 2005 and 2004 results have been reclassified for purposes of comparison.

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- (2) Entel Bolivia group is included in Other Activities.
- (3) 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).
- (4) The data relating to 2005 and 2004 have been reclassified and presented consistent with the 2006 presentation.
- (5) The number of employees at year-end excludes employees relating to the consolidated companies considered as discontinued operations/assets held for sale, and includes personnel with temp work contracts.

The table below sets forth revenues, operating income (loss), net income (loss) from discontinued operations/assets held for sale, capital expenditures and number of employees of discontinued operations/ assets held for sale, for the periods indicated:

**Discontinued operations/Assets held for sale**

|  |                   | Mobile<br>(1)                                  | Media<br>(2) | Entel<br>Chile<br>group | IT<br>Market | Sub-Total | Other,<br>adjustments<br>and<br>eliminations<br>(3) | Total  |
|--|-------------------|--|--------------|-------------------------|--------------|-----------|---|--------|
|  |                   | (millions of Euro, except number of employees) |              |                         |              |           |   |        |
| Revenues   | 2006              | 121  |              |                         |              | 121       | (1)   | 120    |
|  | 2005              | 734  | 126          | 238                     | 289          | 1,387     | (53)  | 1,334  |
|  | 2004              | 1,177  | 127          | 925                     | 706          | 2,935     | (142)   | 2,793  |
| Operating income (loss)(3)   | 2006              | 15   |              |                         |              | 15        | (8)   | 7      |
|  | 2005              | 60   | 4            | 36                      | (3)          | 97        | 506   | 603    |
|  | 2004              | 125  | 4            | 96                      | 21           | 246       | (202)   | 44     |
| Net income (loss) from discontinued operations/ assets held for sale | 2006              | 15   |              |                         |              | 15        | (8)   | 7      |
|  | 2005              | 28   | 1            | 26                      | (11)         | 44        | 506   | 550    |
|  | 2004              | 58   | 1            | 49                      | (7)          | 101       | (219)   | (118)  |
| Capital expenditures   | 2006              | 10   |              |                         |              | 10        |   | 10     |
|  | 2005              | 87   | 3            | 27                      | 5            | 122       |   | 122    |
|  | 2004              | 200  | 2            | 141                     | 28           | 371       |   | 371    |
| Number of employees at year-end                                      | 2006              |  |              |                         |              |           |   |        |
|  | 2005              | 863  | 184          |                         |              | 1,047     |   | 1,047  |
|  | 2004 adjusted (4) | 2,961  | 195          | 4,216                   | 4,030        | 11,402    |   | 11,402 |
|  | 2004              | 841  |              |                         | 4,030        | 4,871     |   | 4,871  |

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- (1) Includes: Tim Hellas (sold at the beginning of June 2005), Tim Perù (sold in August 2005) and Digitel Venezuela (sold in May 2006).
- (2) Includes the Gruppo Buffetti (sold in January 2006).
- (3) Adjustments and eliminations relating to the operating income include, among other things:
  - 2006: the gains on the sale of Digitel Venezuela ( 22 million, net of the related incidental charges and provisions for risks and charges) and the provision related to Tim Hellas sold in 2005 ( 30 million);
  - 2005: the gains on the sale of Tim Hellas ( 410 million, net of the related incidental charges) and Tim Perù ( 120 million, net of the related incidental charges), as well as other losses and incidental charges relating to the sale of the Entel Chile group and the Finsiel Group, for a total of 24 million;
  - 2004: the adjustment of the estimated selling price of the Entel Chile group (a loss of 177 million) and the Finsiel group (a loss of 28 million).
- (4) The numbers of employees at December 31, 2006 and at December 31, 2005 are compared both with the adjusted number of employees at December 31, 2004 (which considers as discontinued operations / assets held for sale the same companies considered as such at December 31, 2006 and 2005, namely: the Finsiel Group, Digitel Venezuela, the Entel Chile group, Tim Hellas, Tim Perù and Gruppo Buffetti) and with the historical number of employees at December 31, 2004 (which considers as discontinued operations / assets held for sale the Finsiel Group and Digitel Venezuela).

### 5.5.5 YEAR ENDED DECEMBER 31, 2006 COMPARED WITH YEAR ENDED DECEMBER 31, 2005

In 2006, **consolidated net income attributable to equity holders of the Parent** was 3,014 million (net income of 3,003 million before Minority Interests), compared to consolidated net income attributable to equity holders of the Parent of 3,216 million (net income of 3,690 million before Minority Interests) in 2005.

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The decrease of 202 million in 2006 was principally due to the following factors:

- operating income decreased by 62 million;
- share of profits of associates and joint ventures accounted for using the equity method increased by 28 million;
- lower financial expenses, net of financial income of 14 million: the improvement in the financial management balance ( 173 million) was partly offset by a lower result from investment management and the release in the year 2005 of provisions relating to Avea I.H.A.S. (for details see below Financial Income and Expenses, net );
- higher income taxes of 124 million, due to the increase of the tax base and the provision for income taxes recorded by the Parent Company;
- lower net income from discontinued operations/assets held for sale of 543 million. In 2005, this item included net gains from discontinued operations totaling 506 million;
- lower net income attributable to Minority Interests (a decrease of 485 million), mainly in connection with the TIM merger transaction (tender offer and merger). During 2005, the total control over the mobile business was reached as a result of the tender offer in January and the merger in June.

The following table summarizes the main factors which affected the change in consolidated net income attributable to equity holders of the Parent in 2006:



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V **REVENUES**

Our **consolidated revenues** in 2006 were 31,275 million, an increase of 1,356 million, or 4.5% compared to 29,919 million in 2005.

The growth of revenues particularly reflects the following developments in the Business Units:

- a decrease in revenues of the Wireline Business Unit. An increase in revenues due to the change in the scope of consolidation (mainly attributable to the Liberty Surf Group) and the constant growth of the domestic and European broadband market and wholesale services were more than offset by a decline in the traditional telephony market which was impacted by the reduction in fixed-mobile termination rates and the migration of voice traffic from the fixed to the mobile network;
- a positive contribution by the Domestic Mobile Business Unit, particularly due to the expansion of value-added services, the positive trend of revenues from outgoing voice traffic and the growth of revenues from handset sales, offset in part by the negative impact of the new fixed-mobile and mobile-mobile termination rates that came into effect;
- a significant contribution by the Brazil Mobile Business Unit, driven by the expansion of its customer base, growth in VAS and a positive foreign exchange rate effect. In July 2006, regulatory changes were introduced (abolition of the Bill and Keep rule) which generated a positive impact on revenues and a corresponding increase in interconnection costs;
- an increase in the revenues of the Media Business Unit which showed a positive trend compared to the year 2005 due to national advertising which grew at a faster pace than the market and the contribution made by digital terrestrial Pay-per-View revenues;
- a reduction in the revenues of the Olivetti Business Unit due to the decline in traditional Ink-jet and Gaming sales, which was partly compensated by the growth in specialized printers, new ink jet products and professionals office products;
- an increase in Other activities and eliminations in connection with both lower eliminations on transactions between the Wireline and Domestic Mobile Business Units, mainly as a result of the reduction in termination rates and the migration of voice traffic from the fixed to the mobile network, and also the increase in revenues from Other activities.

Revenues from telecommunications services are shown gross of the portion due to third-party operators of 5,721 million compared with 4,829 million in 2005. Such increase ( 892 million or 18.5%) takes into account the positive impact of the regulatory changes (abolition of the Bill and Keep rule) that were applied to the Brazilian market from July 2006.

Foreign revenues (based on customer geographical location) amounted to 7,969 million in 2006 ( 6,165 million in 2005); 49.3% of the total came from Brazil (46.6% in 2005).

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The table below sets forth, for the periods indicated, gross revenues and consolidated revenues by Business Unit and the percentage of their contributions to our consolidated revenues:

|                       | Year ended December 31,                |                          |                            |                   |                          |                            |
|-----------------------|--|--------------------------|----------------------------|-------------------|--------------------------|----------------------------|
|                       | 2006                                   |                          |                            | 2005              |                          |                            |
|                       | Gross Revenues(1)                      | Consolidated Revenues(2) | % of Consolidated Revenues | Gross Revenues(1) | Consolidated Revenues(2) | % of Consolidated Revenues |
|                       | (millions of Euro, except percentages) |                          |                            |                   |                          |                            |
| Wireline              | 17,795                                 | 16,426                   | 52.5%                      | 17,834            | 16,356                   | 54.7%                      |
| Domestic Mobile       | 10,210                                 | 9,939                    | 31.8%                      | 10,076            | 9,776                    | 32.7%                      |
| Brazil Mobile         | 3,964                                  | 3,959                    | 12.7%                      | 2,900             | 2,895                    | 9.7%                       |
| Media                 | 207                                    | 197                      | 0.6%                       | 180               | 176                      | 0.6%                       |
| Olivetti              | 440                                    | 385                      | 1.2%                       | 452               | 400                      | 1.3%                       |
| Other Activities(3)   | 1,563                                  | 369                      | 1.2%                       | 1,321             | 316                      | 1.0%                       |
| <b>Total revenues</b> | <b>34,179</b>                          | <b>31,275</b>            | <b>100.0%</b>              | <b>32,763</b>     | <b>29,919</b>            | <b>100.0%</b>              |

(1) Gross revenues are total revenues of the various business units of the Telecom Italia Group before elimination of intercompany sales (but after elimination of sales between companies within the same major business area).

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- (2) Data include revenues recorded by each business area on a consolidated basis after elimination of intercompany sales.
- (3) Other activities consist of the Central Functions (Group Functions and Service Units) and the foreign operations not included in other business units (the Entel Bolivia group). For further details on Other Activities please see Item 4. Information on the Telecom Italia Group 4.2 Business Units 4.2.7 Other Telecom Italia Group Activities .

The table below sets forth, for the periods indicated, revenues by geographical area and the percentage of total consolidated revenues:

|                                    | Year ended December 31,                |               |               |               |
|------------------------------------|--|---------------|---------------|---------------|
|                                    | 2006                                   |               | 2005          |               |
| <b>Geographical area</b>           | (millions of Euro, except percentages) |               |               |               |
| Italy                              | 23,306                                 | 74.5%         | 23,754        | 79.4%         |
| Rest of Europe                     | 2,946                                  | 9.4%          | 2,265         | 7.6%          |
| Latin America                      | 4,220                                  | 13.5%         | 3,147         | 10.5%         |
| Other countries                    | 803                                    | 2.6%          | 753           | 2.5%          |
| <b>Total consolidated revenues</b> | <b>31,275</b>                          | <b>100.0%</b> | <b>29,919</b> | <b>100.0%</b> |

**V OTHER INCOME**

**Other income** amounted to 606 million, a decrease of 72 million compared to 678 million in 2005.

The percentage of other income to revenues was 1.9% in 2006 compared to 2.3% in 2005.

Details are as follows:

|  | Year ended December 31, |      |
|--|-------------------------|------|
|  | 2006                    | 2005 |
|  | (millions of Euro)      |      |
| Compensations for late payment of regulated telephone services | 91                      | 105  |
| Release of provisions and other liabilities                    | 179                     | 228  |
| Recovery of costs of personnel and services rendered           | 60                      | 56   |

|   |                 |                 |
|---|-----------------|-----------------|
| Capital grants and grants related to income | 42              | 47              |
| Damage compensations and penalties          | 52              | 35              |
| Other income                                | 182             | 207             |
|   | <u>        </u> | <u>        </u> |
| <b>Total</b>                                | <b>606</b>      | <b>678</b>      |
|   | <u>        </u> | <u>        </u> |

The decrease of 72 million in 2006 is mainly attributable to a reduction of 49 million in the release of provisions and other liabilities (which in 2005 included 37 million of the release of provisions for risks and charges relating to the Antitrust fine of 152 million imposed in 2004 for the alleged abuse of a dominant position in the market which, after appeals by the parties, was reduced to 115 million).

#### V OPERATING EXPENSES

The table below sets forth, for the periods indicated, total consolidated **operating expenses** by major components and expressed as a percentage of total consolidated revenues.

|   | Year ended December 31,                       |                 |                 |                 |
|---|---|-----------------|-----------------|-----------------|
|   | 2006  |                 | 2005            |                 |
|   | <b>(millions of Euro, except percentages)</b> |                 |                 |                 |
| Purchases of materials and external services      | 14,191  | 45.4%           | 12,937          | 43.2%           |
| Personnel costs                                   | 3,801   | 12.1%           | 4,142           | 13.9%           |
| Other operating expenses                          | 1,543   | 4.9%            | 1,468           | 4.9%            |
| Changes in inventories                            | (8)   |                 | 4               |                 |
| Capitalized internal construction costs           | (496)   | (1.6%)          | (471)           | (1.6%)          |
| Depreciation and amortization                     | 5,487   | 17.5%           | 5,232           | 17.5%           |
| Gains/losses on disposals of non-current assets   | (95)  | (0.3%)          | (242)           | (0.8%)          |
| Impairment reversals/losses on non-current assets | 21  | 0.1%            | 28              | 0.1%            |
|   | <u>        </u>                               | <u>        </u> | <u>        </u> | <u>        </u> |
| <b>Total operating expenses</b>                   | <b>24,444</b>                                 | <b>78.1</b>     | <b>23,098</b>   | <b>77.2%</b>    |
|   | <u>        </u>                               | <u>        </u> | <u>        </u> | <u>        </u> |

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Our operating expenses increased by 1,346 million in 2006 compared to 2005; such increase is detailed as follows:

- **Purchases of materials and external services** increased by 1,254 million, or 9.7%, from 12,937 million in 2005 to 14,191 million in 2006. This increase is mainly due to the expansion of Broadband, higher interconnection costs as a result of the growth of traffic managed, as well as the increase in costs for the purchase of products and content.

Purchases of materials and external services included:

|   | Year ended December 31, |               |
|---|-------------------------|---------------|
|   | 2006                    | 2005          |
|   | (millions of Euro)      |               |
| <b>Purchases of materials and merchandise for resale</b>  | <b>(A) 2,578</b>        | <b>2,506</b>  |
| <b>Costs of services:</b>   |                         |               |
| - Revenues due to other TLC operators   | 5,721                   | 4,829         |
| - Commissions, sales commissions and other selling expenses                                       | 1,511                   | 1,263         |
| - Advertising and promotion expenses  | 584                     | 593           |
| - Professional consulting and services  | 480                     | 530           |
| - Utilities   | 421                     | 308           |
| - Maintenance   | 350                     | 339           |
| - Outsourcing costs for other services  | 267                     | 256           |
| - Mailing and delivery expenses for telephone bills, directories and other materials to customers | 106                     | 90            |
| - Other service expenses  | 1,130                   | 1,119         |
|   | <b>(B) 10,570</b>       | <b>9,327</b>  |
| <b>Lease and rental costs:</b>  |                         |               |
| - Property lease rents  | 560                     | 641           |
| - TLC circuit lease rents and rents for use of satellite systems                                  | 271                     | 274           |
| - Other lease and rental costs  | 212                     | 189           |
|   | <b>(C) 1,043</b>        | <b>1,104</b>  |
| <b>Total purchases of materials and external services</b>   | <b>(A+B+C) 14,191</b>   | <b>12,937</b> |

The principal reasons for the increase in Purchases of materials and external services were the following:

- purchases of materials and merchandise for resale increased by 72 million, from 2,506 million in 2005 to 2,578 million in 2006. This increase was mainly attributable to the increase in costs for the purchase of products

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and content. The percentage of purchases of materials and merchandise for resale to revenues was 8.2% (8.4% in 2005);

- costs of services increased by 1,243 million, or 13.3% in 2006 from 9,327 million in 2005 to 10,570 million in 2006 (of which 892 million was attributable to an increase in revenues due to other TLC operators), mainly due to the expansion of Broadband and higher interconnection costs. The percentage of cost of services to revenues was 33.8% (31.2% in 2005);
- lease and rental costs decreased by 61 million, from 1,104 million in 2005 to 1,043 million in 2006. The percentage of lease and rental costs to revenues was 3.3% (3.7% in 2005).
- **Personnel costs** decreased by 341 million, or 8.2%, from 4,142 million in 2005 to 3,801 million in 2006. Such decrease was due mainly to the reduction in charges for termination benefit incentive plans, and, only to a lesser extent, to the reduction of personnel costs at payroll and temp work costs of 28 million, or 0.8%. In particular, personnel costs outside Italy increased by 83 million, or 27.3%, principally due to the increased average number of salaried staff (an increase of 2,094 units); the domestic component decreased by 424 million, or 11.0%, due to the reduction of the above termination benefit incentive plans and the reduced average number of salaried staff in 2006 (a decrease of 1,970 units).

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Personnel costs are detailed as follows:

|  | Year ended December 31, |              |
|--|-------------------------|--------------|
|  | 2006                    | 2005         |
|  | (millions of Euro)      |              |
| <b>Personnel costs at payroll:</b>   |                         |              |
| - Wages and salaries   | 2,625                   | 2,600        |
| - Social security contributions  | 796                     | 813          |
| - Employee severance indemnities   | 146                     | 168          |
| - Other employee-related costs   | 71                      | 88           |
|  | <b>(A)</b>              | <b>3,638</b> |
| <b>Temp work costs</b>   | <b>(B)</b>              | <b>55</b>    |
| <b>Miscellaneous expenses for personnel and for other labor-related services rendered:</b> |                         |              |
| - Remuneration of personnel other than employees   | 18                      | 18           |
| - Charges for termination benefit incentive plans  | 76                      | 394          |
| - Other  | 14                      | 9            |
|  | <b>(C)</b>              | <b>108</b>   |
| <b>Total personnel costs</b>   | <b>(A+B+C)</b>          | <b>3,801</b> |

The Group's average equivalent number of employees in 2006 was 79,993 units (excluding employees related to discontinued operations/assets held for sale and including personnel with temp work contracts) compared to 79,869 units in 2005. The breakdown by category is as follows:

|   | Year ended December 31, |               |
|---|-------------------------|---------------|
|   | 2006                    | 2005          |
|   | (Units)                 |               |
| Executives                                | 1,384                   | 1,541         |
| Middle management                         | 5,065                   | 4,744         |
| White collars                             | 70,748                  | 70,375        |
| Blue collars                              | 417                     | 722           |
| <b>Total employees at payroll</b>         | <b>77,614</b>           | <b>77,382</b> |
| <b>Personnel with temp work contracts</b> | <b>2,379</b>            | <b>2,487</b>  |

|                        |               |               |
|------------------------|---------------|---------------|
| <b>Total employees</b> | <b>79,993</b> | <b>79,869</b> |
|------------------------|---------------|---------------|

- **Other operating expenses** increased by 75 million (or 5.1%), from 1,468 million in 2005 to 1,543 million in 2006. Such operating expenses consist of the following:

|   | <b>Year ended December 31,</b> |              |
|---|--------------------------------|--------------|
|   | <b>2006</b>                    | <b>2005</b>  |
|   | <b>(millions of Euro)</b>      |              |
| Impairments and charges for bad debts         | 564                            | 521          |
| Provision for risks and charges               | 107                            | 71           |
| TLC operating fees                            | 236                            | 181          |
| Taxes on revenues of South American companies | 222                            | 178          |
| Duties and indirect taxes                     | 156                            | 141          |
| Association fees and dues                     | 16                             | 19           |
| Other expenses                                | 242                            | 357          |
| <b>Total other operating expenses</b>         | <b>1,543</b>                   | <b>1,468</b> |

The increase in Other operating expenses was mainly due to the increases in impairments and charges for bad debts ( 43 million), provision for risks and charges ( 36 million), TLC operating fees ( 55 million), taxes on revenues of South American companies ( 44 million) and duties and indirect taxes ( 15 million), partially offset by decreases in association fees and dues ( 3 million) and other expenses ( 115 million).



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- **Capitalized internal construction costs** include sales of equipment, installations and services at market prices by Group companies to other Group companies. These costs increased by 25 million (or 5.3%), from 471 million in 2005 to 496 million in 2006, and consist of the following:

|  | Year ended December 31, |            |
|--|-------------------------|------------|
|  | 2006                    | 2005       |
|  | (millions of Euro)      |            |
| <b>Capitalized internal construction costs on:</b>   |                         |            |
| Intangible assets with a finite life                 | 318                     | 287        |
| Property, plant and equipment owned                  | 178                     | 184        |
| <b>Total capitalized internal construction costs</b> | <b>496</b>              | <b>471</b> |

- **Depreciation and amortization** increased by 255 million (or 4.9%), from 5,232 million in 2005 to 5,487 million in 2006. The percentage of depreciation and amortization to revenue was 17.5% in 2006 and 2005.

Depreciation and amortization are detailed as follows:

|  | Year ended December 31, |              |
|--|-------------------------|--------------|
|  | 2006                    | 2005         |
|  | (millions of Euro)      |              |
| <b>Amortization of Intangible assets with a finite life:</b>     |                         |              |
| Industrial patents and intellectual property rights              | 1,760                   | 1,414        |
| Concessions, licenses, trademarks and similar rights             | 310                     | 253          |
| Other intangible assets  | 110                     | 17           |
|  | <b>(A) 2,180</b>        | <b>1,684</b> |
| <b>Depreciation of tangible assets owned:</b>                    |                         |              |
| Civil and industrial buildings                                   | 48                      | 103          |
| Plant and equipment  | 2,644                   | 2,910        |
| Manufacturing and distribution equipments                        | 33                      | 31           |
| Aircrafts and ships  | 7                       | 9            |
| Other assets   | 446                     | 363          |
|  | <b>(B) 3,178</b>        | <b>3,416</b> |
| <b>Depreciation of tangible assets held under finance lease:</b> |                         |              |
| Civil and industrial buildings                                   | 99                      | 93           |
| Plant and equipment  | 1                       | 1            |
| Aircrafts and ships  | 4                       | 4            |

|  |                |              |              |
|--|----------------|--------------|--------------|
| Other assets                               |                | 25           | 34           |
|  | (C)            | 129          | 132          |
| <b>Total depreciation and amortization</b> | <b>(A+B+C)</b> | <b>5,487</b> | <b>5,232</b> |

**Amortization of intangible assets with a finite life** increased by 496 million in 2006 partly due to higher capital expenditures for the development of systems and new services, as well as the strengthening in 2006 compared to 2005 of the average exchange rate of the Brazilian Real against the euro in the Mobile Business Unit.

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**Depreciation of tangible assets (owned and held in leasing)** decreased by 241 million. In particular, the decrease was due to the effects of the revision in 2006 of the depreciation rates for assets relating the fixed and mobile network (a reduction of 319 million) which was partially offset by increases due to higher capital expenditures for the development of infrastructures for the network and as support to the business as well as foreign exchange rate effects of the Brazilian companies in the Mobile Business Unit.

- **Gains/losses on disposals of non-current assets** changed from a net gain of 242 million in 2005 to a net gain of 95 million in 2006 (a reduction in net gain of 147 million). In particular, in 2006, such item included:
  - gains of 135 million, net of incidental expenses, relating to additional real estate property sales made by the Group in 2006 to the closed-end Raissa and Spazio Industriale Funds as part of the property sales program approved by the Board of Directors meeting held on December 21, 2005. In 2005 the gain arising from the realization of the first part of the program was 264 million;
  - the gain of 27 million on the sale of the entire real estate investment held in Ruf Gestion;
  - the loss of 33 million on the sale of the entire investment in Telecom Italia Learning Services;
  - the loss of 9 million on the sale of the Radiomaritime Activities business; and
  - the loss of 25 million as net balance between gains and losses on the sale of other non-current assets.
- **Impairment losses on non-current assets** decreased by 7 million, or 25.0%, from a loss of 28 million in 2005 to a loss of 21 million in 2006 mainly attributable to non current assets of the Latin American Nautilus group.

**V OPERATING INCOME**

**Operating income** decreased by 62 million, or 0.8%, from 7,499 million in 2005 to 7,437 million in 2006. As a percentage of revenues, operating income was 23.8% in 2006 (25.1% in 2005).

**V SHARE OF PROFITS (LOSSES) OF ASSOCIATES AND JOINT VENTURES ACCOUNTED FOR USING THE EQUITY METHOD**

The **Share of profits (losses) of associates and joint ventures accounted for using the equity method** recorded profits of 51 million (profits of 23 million in 2005), an increase of 28 million compared with 2005.

Share of profits (losses) of associates and joint ventures accounted for using the equity method includes:

|   | Year ended December 31, |           |
|---|-------------------------|-----------|
|   | 2006                    | 2005      |
|   | (millions of Euro)      |           |
| ETECSA.   | 47                      | 45        |
| Sofora Telecomunicaciones S.A.  | 3                       | 16        |
| Solpart Participações S.A.  | 1                       | 94        |
| Avea I.H.A.S.   |                         | (122)     |
| Other investments   |                         | (10)      |
| <b>Total share of profits (losses) of associates and joint ventures accounted for using the equity method</b> | <b>51</b>               | <b>23</b> |

For further details about the above mentioned investments accounted for using the equity method please see Item 4. Information on the Telecom Italia Group 4.2 Business Units 4.2.7 Other Telecom Italia Group Activities , and Note 8 Other Non-current assets of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report.

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## V FINANCIAL INCOME AND EXPENSES, NET

**Total financial income and expenses** showed a net expense balance of 1,973 million (a net expense balance of 1,987 million in 2005), representing an improvement of 14 million compared to 2005.

The percentage of net financial expense to revenues was 6.3% compared with 6.6% in 2005.

Net financial income and expenses are detailed as follows:

|  | Year ended December 31, |                |
|--|-------------------------|----------------|
|  | 2006                    | 2005           |
|  | (millions of Euro)      |                |
| Financial management balance(*)                              | (2,332)                 | (2,505)        |
| Investment management and Avea provisions released to income | 359                     | 518            |
| <b>Total financial income and expenses, net</b>              | <b>(1,973)</b>          | <b>(1,987)</b> |

(\*) It refers mainly to net interest expenses and other borrowing costs, foreign exchange gains and losses, and income and expenses from hedging and non-hedging derivatives.

Net financial expense in 2006 decreased by 14 million due to the following factors:

- the improvement in the financial management balance of 173 million mainly as a result of the reduction in net average debt exposure during 2006 compared to 2005 which more than compensated for the negative impact arising from the increase of interest rates on the floating rate portion of debt;
- a decrease of 159 million due to investment management and to the release in the year 2005 of provisions relating to Avea I.H.A.S..

In 2006 the investment management balance and AVEA provisions released to income totaling 359 million comprised:

- the gain on the sale of Avea I.H.A.S ( 72 million) in the third quarter of 2006 and, at the same time, the release to income of the remaining provisions for sureties provided to banks ( 121 million);

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- the gain on the sale of the entire 4.99% stake held in Neuf Télécom ( 148 million);
- other income relating to investment management ( 18 million).

In 2005, the investment management balance and AVEA provisions released to income totaling 518 million comprised:

- the release to income of a portion of the provisions set aside for sureties provided to banks which had financed Avea I.H.A.S. since there was no longer a risk owing to the cancellation of a part of the guarantees ( 423 million);
- gains connected with the sales of C-Mobil ( 61 million), the investment in Intelsat ( 2 million) and Golden Lines ( 5 million).

For further details about financial income and expenses, net please see Note 36 Financial income and Note 37 Financial expenses , respectively, of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report.

### V INCOME FROM CONTINUING OPERATIONS BEFORE TAXES

**Income from continuing operations before taxes** decreased by 20 million (from 5,535 million in 2005 to 5,515 million in 2006).

As a percentage of revenues, income from continuing operations before taxes was 17.6% in 2006 (18.5% in 2005).

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**V INCOME TAXES**

**Income taxes** for the year increased by 124 million, or 5.2%, from 2,395 million in 2005 to 2,519 million in 2006. Such change was mainly due to the increase in taxable income as well as to the provision for income taxes recorded by the Parent Company Telecom Italia.

For further details about income taxes, please see Note 38 Income taxes of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report.

The percentage of income taxes to revenues was 8.1% in 2006 compared to 8.0% in 2005.

**V NET INCOME FROM CONTINUING OPERATIONS**

**Net income from continuing operations** decreased by 144 million, or 4.6%, from 3,140 million in 2005 to 2,996 million in 2006. This decrease was due to the small decline in income from continuing operations before taxes and the higher level of taxes in 2006 compared to 2005.

As a percentage of revenues, net income from continuing operations was 9.6% in 2006 (10.5% in 2005).

**V NET INCOME (LOSS) FROM DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE**

**Net income from discontinued operations/assets held for sale** decreased by 543 million, from 550 million in 2005 to 7 million in 2006 and included:

- 31 million relating to the gain, net of incidental expenses, arising from the sale of Digitel Venezuela in May 2006;
- 9 million for a provision for risks and charges recorded in connection with the sale of Digitel Venezuela;
- 15 million for the positive contribution to net income by the same Digitel Venezuela for the first four months of 2006;
- 30 million for a provision recorded in connection with the sale of Tim Hellas carried out in 2005.

In 2005 we had more significant asset sales which resulted in the high level of net income in that year which included the gains, net of incidental expenses, on the sales of Tim Hellas ( 410 million) and Tim Perù ( 120 million), losses and incidental charges on the sales of the Finsiel group, the Entel Chile group and Gruppo Buffetti ( 24 million) and the net income of companies classified as discontinued operations/assets held for sale ( 44 million).

V **NET INCOME FOR THE YEAR**

**Net income for the year** in 2006 decreased by 687 million, or 18.6%, from 3,690 million in 2005 to 3,003 million in 2006.

As a percentage of revenues, net income for the year was 9.6% in 2006 (12.3% in 2005).

In particular:

- net income attributable to equity holders of the Parent in 2006 was 3,014 million compared with 3,216 million in 2005, showing a decrease of 202 million;
- net income (loss) attributable to Minority Interest in 2006 was a 11 million loss compared with 474 million of income in 2005, a decline of 485 million mainly due to the TIM merger transaction (tender offer and merger). During 2005, Telecom Italia S.p.A. acquired full control over the mobile business through a tender offer in January 2005 and the merger in June 2005 with the consequent effect of eliminating Minority Interests attributable to TIM.



**Table of Contents****Item 5. Operating And Financial Review And Prospects****Results Of Operations For The Three Years Ended December 31, 2006****5.5.6 RESULTS OF OPERATIONS OF BUSINESS UNITS FOR THE YEAR ENDED DECEMBER 31, 2006 COMPARED WITH THE YEAR ENDED DECEMBER 31, 2005.****V OPERATIONS**

On October 5, 2005, the Board of Directors of Telecom Italia adopted the One Company Model organizational structure by converging the two previous Wireline and Mobile Business Units into one single unit (Operations).

For purposes of accounting presentation, Wireline continues to be shown separately and starting from 2006, Mobile activities have been divided into Domestic Mobile and Brazil Mobile.

In order to present an overall picture of Operations, the following table shows the key results for the year ended December 31, 2006, compared to the corresponding items of the year ended December 31, 2005, reclassified for purposes of comparison.

| <b>Operations</b>               | <b>Year ended December 31,</b>                              |             |
|---------------------------------|---|-------------|
|                                 | <b>2006</b>   | <b>2005</b> |
|                                 | <b>(millions of Euro, except percentages and employees)</b> |             |
| Gross revenues                  | 30,388  | 29,096      |
| Operating income                | 8,148   | 8,144       |
| % of gross revenues             | 26.8  | 28.0        |
| Number of employees at year-end | 76,457  | 77,754      |

A commentary on the operating and financial performance and the principal activities carried out during 2006 by Operations (Wireline, Domestic Mobile and Brazil Mobile) follows herewith.

**V WIRELINE**

The following table sets forth, for the periods indicated, certain financial and other data for the Wireline Business Unit.

| <u>Wireline</u>                 | Year ended December 31,                              |         |
|---------------------------------|--|---------|
|                                 | 2006   | 2005(1) |
|                                 | (millions of Euro, except percentages and employees) |         |
| Gross revenues                  | 17,795   | 17,834  |
| Operating income                | 4,396  | 4,488   |
| % of gross revenues             | 24.7   | 25.2    |
| Number of employees at year-end | 55,705   | 56,987  |

(1) As a result of the new organizational structure of the Group approved on October 5, 2005 (the so-called **One Company Model** ), the activities of the Innovation & Engineering Services business segment of Telecom Italia (ex-TILAB segment of Telecom Italia, previously included in Other activities) were transferred to the Wireline Business Unit; therefore 2005 results have been reclassified for purposes of comparison.

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The following table sets forth, for the periods indicated, certain statistical data for Wireline.

|   | As of and for the<br>year ended December 31, |        |
|---|--|--------|
|   | 2006   | 2005   |
| <b>Subscriptions and customers:</b>   |  |        |
| Fixed network connections in Italy (thousands)(1)                                   | 23,698                                       | 25,049 |
| Physical accesses (Consumer + Business) (thousands)                                 | 20,540                                       | 21,725 |
| Voice pricing plans (thousands)(2)  | 6,468  | 6,321  |
| Broadband Accesses (thousands)(3):  | 8,660  | 7,020  |
| • Domestic (thousands)  | 6,770  | 5,707  |
| • European, other than domestic (thousands)   | 1,890  | 1,313  |
| Alice page views (ex-Virgilio) (millions)   | 13,283                                       | 9,842  |
| Alice (ex-Virgilio) average monthly single visitors (millions)                      | 19.1   | 15.7   |
| <b>Network infrastructure in Italy:</b>   |  |        |
| • Access network in copper (millions of km-pair)                                    | 105.7  | 105.2  |
| • Access network and transport in optical fibers (millions of km of optical fibers) | 3.7  | 3.7    |
| <b>Network infrastructure outside Italy:</b>  |  |        |
| • European backbone (km of optical fibers)  | 51,000                                       | 51,000 |
| <b>Wireline Traffic:</b>  |  |        |
| Wireline total traffic (Retail and Wholesale) (billions of minutes)                 | 173.8  | 185.1  |
| <i>of which:</i>  |  |        |
| • <i>Domestic</i>   | 160.1  | 171.3  |
| • <i>International</i>  | 13.7   | 13.8   |

(1) Data exclude internal lines.

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

(3) Number of contracts.

**Gross Revenues** decreased by 39 million, or 0.2%, from 17,834 million in 2005 to 17,795 million in 2006.

Gross revenues were significantly affected by the reduction in the fixed-mobile termination rates (a decrease in gross revenues of 152 million), which took place starting from the second half of 2005, the acceleration of the migration of voice traffic from the fixed to the mobile network, as well as adjustments for amounts on premium services for traffic not recognized by customers ( 43 million). This traffic was identified, by the customers themselves, as the result of the fraudulent conduct of third parties. These decreases were partly offset by the strong growth of the European and domestic broadband market.

Wireline tracks revenues in the following business areas: Retail Telephone, Retail Internet, Data Business, Wholesale and European Broadband Project.

- **Retail Telephone.** Retail Telephone services consist mainly of services offered using traditional technology (PSTN and ISDN) as well as innovative technology (VoIP). Retail telephone services include: access to the network, traffic (in terms of minutes of retail traffic and tariff packages), equipment rental and assurance and value added services for voice. Retail Telephone revenues consist mainly of traffic revenues, fee revenues and sales revenues. In particular, traffic revenues are directly related to traffic volumes, tariffs and fees for tariff packages; fees are attributable to access fees, fees for additional services and for equipment rental and assurance; sales revenues are related to sales of equipment (telephones).

Revenues from Retail Telephone were 9,308 million in 2006, a decrease of 787 million, or 7.8% from 10,095 million in 2005. This business area was marked by a decrease in traffic as a result of the migration from fixed line to mobile traffic, reduced revenues due to changes in the regulatory framework (reduced charges associated with fixed-mobile termination and the 12XY subscriber information services) and pressure from competitors over prices in the Top Customer segment.

- **Retail Internet.** Revenues from Retail Internet consist primarily of revenues from ADSL (mass market broadband access) for access fees and traffic, and revenues from Internet dial-up traffic revenues.

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Revenues from Retail Internet were 1,511 million in 2006, an increase of 74 million, or 5.2% from 1,437 million in 2005, principally due to the growth in broadband revenues (an increase of 127 million, 11.5% compared to 2005). Wireline's portfolio of broadband retail customers in Italy at December 31, 2006 totaled approximately 5.6 million accesses (an increase of 17.1% compared to December 31, 2005).

In 2006, certain revenues relating to some offerings to business customers were reclassified from Data Business revenues to Retail Internet revenues; as a result of this, in 2005 such revenues were consistently reclassified with an increase in Retail Internet revenues of 240 million (from 1,197 million to 1,437 million) and a decrease for the same amount in Data Business revenues (from 2,107 million to 1,867 million).

- **Data Business.** Data Business consist primarily of data transmission and network services for business customers and leased lines (trunk lines offering a customer-subscriber a permanent connection for telecommunication services between two geographically separate points). This kind of connection can be used to handle high volume voice, data or video transmission.

Revenues from Data Business were 1,743 million in 2006, a decrease of 124 million, or 6.6% compared to 1,867 million in 2005. This reduction, due to stronger competition in the Corporate client market and to the pricing review of certain contracts with public authorities, is particularly evident in leased lines services (a decrease of 58 million) and traditional Data Transmission using data packet technology (a decrease of 58 million). ICT services, however, recorded a positive performance, continuing its growth trend (an increase of 52 million, or 9.5% compared to 2005).

- **Wholesale.** Wholesale consists of domestic 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 were 3,989 million in 2006, an increase of 463 million, or 13.1% compared to 2005 ( 3,526 million in 2005).

Revenues from Domestic Wholesale services were 2,131 million in 2006, an increase of 180 million, or 9.2% compared to 2005 ( 1,951 million in 2005); revenues from International Wholesale services were 1,858 million in 2006, an increase of 283 million, or 18.0% compared to 2005 ( 1,575 million in 2005).

- **European Broadband Project.** Revenues from the European Broadband Project (France, Germany and The Netherlands), were 915 million in 2006 (an increase of 350 million compared to 2005). Wireline's overall portfolio of European broadband customers at December 31, 2006 was 1,890,000 (an increase of 577,000 units, or 43.9% compared to 2005), while total customers were 2.15 million.

In detail, the following table sets forth, for the periods indicated, certain financial and other data for the European Broadband Project.

| <b>European Broadband Project</b> | <b>Year ended December 31,</b>                              |             |
|-----------------------------------|---|-------------|
|                                   | <b>2006</b>   | <b>2005</b> |
|                                   | <b>(millions of Euro, except percentages and employees)</b> |             |
| Gross revenues                    | 915   | 565         |
| Operating loss                    | (125)   | (117)       |
| % of gross revenues               | (13.7)  | (20.7)      |
| Number of employees at year-end   | 3,066   | 2,494       |

The contribution of the Wireline Business Unit to our consolidated revenues amounted to 16,426 million in 2006 and 16,356 million in 2005.

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**Operating income** decreased by 92 million, or 2.0%, from 4,488 million in 2005 to 4,396 million in 2006 and was highly affected by the variation in the revenue mix and by the added push given to sales to support new business initiatives as a result of competitive pressure in Italy.

With regard to changes in costs, the following is noted:

- purchases of materials and external services were 7,692 million in 2006, an increase of 3.6% compared to 2005. The growth of 266 million is principally due to the costs associated with investment in the development of broadband in Europe ( 246 million);
- personnel costs were 2,635 million in 2006, a decrease of 192 million, or 6.8% compared to 2005. The decrease was largely due to the reduction in employees as well as lower restructuring costs (a decrease of 160 million);
- other operating expenses were 639 million in 2006, an increase of 79 million compared to 2005. This increase is due in part to the inclusion in 2006 of an accrual set aside for the arbitration proceedings initiated by Fastweb with regard to the execution of the contract for Local Loop Unbundling ( 61 million).

In 2006 Telecom Italia performed a review of the estimated useful life of its tangible assets in order to bring them into line with the technological and market developments of the last few years and also with the convergence of fixed mobile telecommunications. This review resulted in an increase in operating income for the Wireline Business Unit as depreciation charges were lowered by 219 million. This positive effect was largely offset by an increase in the amortization charge for intangible assets, mainly software.

**Operating margin** decreased to 24.7% in 2006 compared to 25.2% in 2005.

**V DOMESTIC MOBILE**

The following table sets forth, for the periods indicated, certain financial and other data for the Domestic Mobile Business Unit.

The 2006 data refers to Tim Italia S.p.A. through the date of the merger of Tim Italia S.p.A. into Telecom Italia S.p.A. (March 1, 2006), and to Telecom Italia S.p.A.'s domestic mobile segment for the period March-December 2006. The 2005 data refers to TIM S.p.A. (the Company's former subsidiary through which the domestic mobile operations were conducted), through the date of the demerger of the mobile operations to Tim Italia S.p.A. (March 1, 2005), and to Tim Italia S.p.A. in the period March-December 2005.

| <b>Domestic Mobile</b> | <b>Year ended December 31,</b> |             |
|------------------------|--------------------------------|-------------|
|                        | <b>2006</b>                    | <b>2005</b> |

|                                 | (millions of Euro, except<br>percentage and employees) |        |
|---------------------------------|--|--------|
| Gross revenues                  | 10,210   | 10,076 |
| Operating income                | 3,742  | 3,856  |
| % of gross revenues             | 36.7   | 38.3   |
| Number of employees at year-end | 11,218   | 11,720 |



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The following table sets forth, for the periods indicated, certain Domestic Mobile statistical data.

|  | Year ended December 31, |        |
|--|-------------------------|--------|
|  | 2006                    | 2005   |
| Mobile telephone lines in Italy at year-end (thousands)(1)                 | 32,450                  | 28,576 |
| GSM subscriber lines (thousands)   | 4,370                   | 3,186  |
| Prepaid GSM/UMTS lines (thousands)   | 28,080                  | 25,296 |
| Customer growth(%)   | 13.6                    | 8.8    |
| Churn rate(2)  | 16.4                    | 16.9   |
| Average monthly revenues per line ( ) (3)                                  | 25.6                    | 29.3   |
| Total Mobile outgoing traffic per month (millions of minutes)              | 2,443                   | 2,314  |
| Total Mobile incoming and outgoing traffic per month (millions of minutes) | 3,730                   | 3,550  |

(1) Includes Prepaid Customers and excludes the inactive lines. Also includes 25,000 TACS subscriber lines as of December 31, 2005, while TACS prepaid lines were 69,000 as of December 31, 2005.

(2) The figures refer to the total number of lines. The churn rate for a given period represents the number of mobile customers who ceased to be customers during the period (by choice or due to unpaid bills) expressed as a percentage of the average number calculated on the basis of the annual numbers of customers during the period.

(3) Includes total revenues from fees, traffic (domestic and not) and VAS, excluding revenues from the sale of products.

**Gross revenues** increased by 134 million, or 1.3%, from 10,076 million in 2005 to 10,210 million in 2006. Gross revenues were negatively impacted by the new termination price list which came into force (the price paid by fixed line operators when calls terminate on the mobile network) which reduced revenues by 372 million. Excluding such impact, gross revenues would have increased by 5% in 2006 compared to 2005.

The increase in 2006 revenues was principally due to the strong increase in VAS revenues to 1,649 million in 2006 (an increase of 152 million, or 10.2% compared to 2005) due to the continuing innovation of services and the portfolio of offerings on interactive services: revenues from interactive services increased by 103 million, or 20.2% compared to 2005. The percentage of VAS revenues to gross revenues was 16.2% in 2006 (14.9% in 2005) and the percentage of VAS revenues to services revenues was 17.5% in 2006 (16.0% in 2005).

Revenues from voice services ( 7,292 million in 2006) were impacted by an increase in outgoing traffic (an increase of 141 million, or 2.6%), which was more than offset by the decrease in incoming traffic (a decrease of 288 million, or 14.2%) and by the reduction in termination charges (a decrease of 372 million). Excluding the negative impact, due to the reduction in termination charges, revenues from voice services would have increased by 83 million, or 4.1%.

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Revenues from equipment sales were 812 million in 2006, an increase of 106 million, or 15.0% compared to 2005. In 2006, 7.4 million handsets were sold (an increase of 1.6 million compared to 2005), of which 2.5 million related to UMTS handsets.

The contribution of the Domestic Mobile to our consolidated revenues was 9,939 million in 2006 and 9,776 million in 2005.

**Operating income** decreased by 114 million, or 3.0%, from 3,856 million in 2005 to 3,742 million in 2006. Such decrease was mainly due to increased costs (including higher levels of amortization of intangibles), as described below:

- purchases of materials and external services of 4,837 million in 2006, an increase of 6.8% compared to 2005 ( 4,529 million). This increase ( 308 million) is principally due to higher interconnection costs ( 129 million, mainly as a result of greater off-net traffic volumes), higher purchase costs for products and content ( 189 million) and electrical power used on industrial installations ( 30 million, principally attributable to price increases);
- personnel costs were 469 million in 2006 a decrease of 79 million, or 14.4%, compared to 2005 ( 548 million). This decrease was principally due to lower average number of employees, as well as restructuring costs (a decrease of 14 million); and
- other operating expenses were 147 million in 2006, an increase of 16 million, or 12.2% compared to 2005 ( 131 million).

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In 2006 Telecom Italia performed a review of the estimated useful life of its tangible assets in order to bring them into line with the technological and market developments of the last few years and also with the convergence of fixed mobile telecommunications. The impact on the Domestic Mobile Business Unit of such review was to lower depreciation charges for tangible assets by 100 million. This positive effect was offset by an increase in the amortization charge for intangible assets, mainly referring to software.

In 2006, following the introduction of new contracts which bind the customer to the Telecom Italia Group for 24 months, or a penalty is applied, the Group capitalized subscriber acquisition costs in intangible assets and recognizes them in the statement of income over the period of the underlying contract. The capitalization of subscriber acquisition costs in 2006 resulted in higher amortization charges of 34 million compared to 2005.

**Operating margin** decreased from 38.3% in 2005 to 36.7% in 2006.

**V BRAZIL MOBILE**

The following table sets forth, for the periods indicated, certain financial and other data for Brazil Mobile Business Unit.

| <b>Brazil Mobile</b>            | <b>Year ended December 31,</b>                             |             |
|---------------------------------|--|-------------|
|                                 | <b>2006</b>  | <b>2005</b> |
|                                 | <b>(millions of Euro, except percentage and employees)</b> |             |
| Gross revenues                  | 3,964  | 2,900       |
| Operating income (loss)         | 21   | (190)       |
| % of gross revenues             | 0.5  | (6.5)       |
| Number of employees at year-end | 9,531  | 9,043       |

**Gross revenues** were 3,964 million in 2006 compared to 2,900 million in 2005, an increase of 1,064 million, or 36.7%. The increase was due to the growth in the customer base (25.4 million mobile lines at December 31, 2006 compared with 20.2 million mobile lines at December 31, 2005), as well as the contribution made by value-added services (which rose from 5.7% of revenues in 2005 to 6.9% in 2006).

In July 2006, Anatel (the Brazilian regulatory agency) eliminated the Bill and Keep regulation under which mobile operators, until that date, had not received or paid interconnection charges on the minutes of local mobile-mobile traffic when the balance between the incoming and outgoing minutes exchanged with a operator fell within a 45%-55% range. This change had a positive impact on

revenues in 2006 of 262 million and a similar increase in interconnection charges.

The contribution of the Brazil Mobile Business Unit to our consolidated revenues amounted to 3,959 million in 2006 and 2,895 million in 2005.

**Operating income** in 2006 was 21 million compared to an operating loss of 190 million in 2005, an improvement of 211 million. The improvement in 2006 was due to the above mentioned increase in gross revenues, although such increase was offset in large part by higher costs. The increased costs were attributable to the following reasons:

- purchases of materials and external services were 2,210 million in 2006, an increase of 22.5% compared to 2005 ( 1,804 million), mainly due to the aforementioned increase in interconnection charges. Such purchases as a percentage of gross revenues were 55.8% (62.2% in 2005);
- personnel costs were 209 million in 2006 and increased by 31.4% compared to 2005 ( 159 million) due to the increase in the number of personnel. Personnel costs as a percentage of gross revenues were 5.3% (5.5% in 2005);

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- other operating expenses were 642 million in 2006 and increased by 26.1% compared to 2005 ( 509 million). They include sundry expenses ( 466 million in 2006 compared to 378 million in 2005), principally made up of indirect taxes and duties, TLC operating fees, writedowns and bad debts expense ( 164 million in 2006 compared to 117 million in 2005) and other items ( 11 million in 2006 compared to 15 million in 2005);
- depreciation and amortization were 929 million in 2006 and increased by 44.0% compared to 2005 ( 645 million) as a consequence of higher investments in network infrastructure and information systems. Effective January 1, 2006, subscriber acquisition costs (referring to subsidies for the purchase of handsets when there are contracts binding the customer to the company for a period of at least 12 months, otherwise a penalty is applied in the event of the early cancellation of the contract) are capitalized and amortized in relation to the revenues and on the basis of the period of the contract. In 2006, such capitalization resulted in higher amortization of 58 million.

**V MEDIA**

The following table sets forth, for the periods indicated, certain financial and other data for the Media Business Unit.

| <b>Media</b>                    | <b>Year ended December 31,</b>                             |             |
|---------------------------------|--|-------------|
|                                 | <b>2006</b>  | <b>2005</b> |
|                                 | <b>(millions of Euro, except percentage and employees)</b> |             |
| Gross revenues                  | 207  | 180         |
| Operating loss                  | (137)  | (130)       |
| % of gross revenues             | (66.2)   | (72.2)      |
| Number of employees at year-end | 919  | 886         |

**Gross revenues** increased by 27 million, or 15.0%, from 180 million in 2005 to 207 million in 2006. The increase in gross revenues was due to the contribution of domestic advertising sales, which outpaced the flat sales of the Italian advertising market's television sector during 2006, and the growth in digital terrestrial revenues.

In particular:

- revenues in 2006 of the Free to Air analog and satellite business area were 168 million, an increase of 3.6% compared to 2005;

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- revenues from Digital Terrestrial Television were 32 million, compared to 10 million in 2005;
- revenues from the News area were 9 million, an increase of 38.8% compared to 2005.

The contribution of the Media Business Unit to our consolidated revenues amounted to 197 million in 2006 and 176 million in 2005.

**Operating loss** increased by 7 million (a loss of 130 million in 2005 compared to a loss of 137 million in 2006), mainly due to an increase in depreciation and amortization charges (18 million) in the Television area as a result of investments made during 2005 following the acquisition of a new nationally-televised network, as well as the acquisitions made in 2006 of new frequencies for Digital Terrestrial TV.

2006 operating loss (excluding depreciation and amortization) improved in analog and satellite Free to Air broadcasting, driven by the growth of national advertising (an increase of 10.8%). The improvement was also a reflection of La7's actions to concentrate its resources on adding more programs to its schedule with a higher audience/advertising return and MTV's actions of developing new multichannel/multiplatform strategies. Digital terrestrial TV, notwithstanding an improvement in pay-per-view margins, still loss-making, reported higher operating costs associated with the start-up of the new free channels (e.g. La7 Sport and Flux) in relation to which advertising revenues remained negligible.

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The following table sets forth, for the periods indicated, certain financial and other data for the Olivetti Business Unit.

| <b>Olivetti</b>                 | <b>Year ended December 31,</b>                      |             |
|---------------------------------|---|-------------|
|                                 | <b>2006</b>   | <b>2005</b> |
|                                 | (millions of Euro, except percentage and employees) |             |
| Gross revenues                  | 440   | 452         |
| Operating loss                  | (50)  | (38)        |
| % of gross revenues             | (11.4)  | (8.4)       |
| Number of employees at year-end | 1,428   | 1,750       |

**Gross revenues** decreased by 12 million, or 2.7% from 452 million in 2005 to 440 million in 2006. Excluding the effects of change in the scope of consolidation, exchange rates and the sale of intellectual properties, the decrease in gross revenues would have been 5 million (-1.1%). The decrease is mainly due to a decrease in revenues related to products for Gaming and traditional Ink-jet products, which were only partly offset by higher revenues of specialized printers, new Ink-jet products (multifunctional color printers and portable photo printers launched on the market during the last months of 2005) and professional Office products.

The contribution of the Olivetti Business Unit to our consolidated revenues was 385 million in 2006 and 400 million in 2005.

**Operating loss** increased by 12 million, or 31.6% from 38 million in 2005 compared to 50 million in 2006 principally due to the decrease in revenues.

**5.5.7 YEAR ENDED DECEMBER 31, 2005 COMPARED WITH YEAR ENDED DECEMBER 31, 2004**

In 2005, our **consolidated net income attributable to equity holders of the Parent** was 3,216 million (net income of 3,690 million before Minority Interests), compared to consolidated net income attributable to equity holders of the Parent of 1,815 million (net income of 2,834 million before Minority Interests) in 2004.

The increase of 1,401 million in 2005 was principally due to the following factors:

- a higher share of profits in associates accounted for using the equity method, of 28 million;
- lower financial expenses, net of financial income, of 5 million. In particular, in 2005, financial income included the release to the statement of income of a portion of provisions recorded in 2002 for the guarantees provided by the Group to banks which had financed AVEA I.H.A.S., our interest in mobile operations in Turkey, since the risk had ceased with respect to the cancellation of the same guarantees ( 423 million), partially offset by higher financial expenses due to the increase in indebtedness connected with the tender offer for TIM shares and lower capital gains from the management of investments ( 418 million);
- lower income taxes of 259 million;
- an increase in net income from discontinued operations / assets held for sale of 668 million. In 2005 net income from discontinued operations/assets held for sale amounted to 550 million compared to a net loss of 118 million in 2004. 2005 included 410 million relating to the net gain realized on the sale of the entire investment held in Tim Hellas and 120 million relating to the net gain realized on the sale of the entire investment held in Tim Perù; and
- lower net income attributable to Minority Interests of 545 million ( 474 million in 2005 compared to 1,019 million in 2004), mainly arising from the integration of TIM (tender offer and merger), which led to full control over the Domestic Mobile business.



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These factors which increased net income were offset in part by a decrease in operating income of 104 million.

The following table summarizes the main factors which affected the change in consolidated net income attributable to equity holders of the Parent in 2005:

**V REVENUES**

Our **consolidated revenues** in 2005 were 29,919 million, an increase of 1,627 million or 5.8% compared to 28,292 million in 2004.

The increase in revenues was principally due to:

- a significant contribution to revenue by the Brazil Mobile Business Unit (chiefly attributable to the activities of the Tim Brasil group and to the positive foreign exchange effect) and the Domestic Mobile Business Unit (due to the increased level of value-added services and the sale of 3G handsets);
- an increase in revenues of the Wireline Business Unit due mainly to the expansion of the broadband market, enhanced offerings for wholesale services and the growth of innovative services, particularly Web services, offset by a decline in the traditional telephony market;
- an increase in revenue of the Media Business Unit which benefited from the growth in advertising and start-up activities relating to digital terrestrial television; and
- a reduction in the sales of the Olivetti Business Unit due to the decline in the average prices of fax machines, lower sales volumes of ink-jet heads and the fall in the volumes and prices of the Gaming and specialized printers division.

Revenues from telecommunications services are shown gross of the portion due to third-party operators of 4,713 million ( 4,177 million in 2004).

Foreign revenues amounted to 6,165 million in 2005 ( 4,556 million in 2004); 51.1% of the total came from the Latin America area (44.7% in 2004), principally Brazil.

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The table below sets forth, for the periods indicated, gross revenues and consolidated revenues by Business Unit and the percentage of their contributions to our consolidated revenues:

|  | Year ended December 31, |                          |                            |                   |                          |                            |
|--|-------------------------|--------------------------|----------------------------|-------------------|--------------------------|----------------------------|
|  | 2005                    |                          |                            | 2004              |                          |                            |
|  | Gross Revenues(1)       | Consolidated Revenues(2) | % of Consolidated Revenues | Gross Revenues(1) | Consolidated Revenues(2) | % of Consolidated Revenues |
| (millions of Euro, except percentages) |                         |                          |                            |                   |                          |                            |
| Wireline                               | 17,834                  | 16,356                   | 54.7%                      | 17,508            | 15,843                   | 56.0%                      |
| Domestic Mobile                        | 10,076                  | 9,776                    | 32.7%                      | 9,923             | 9,661                    | 34.2%                      |
| Brazil Mobile                          | 2,900                   | 2,895                    | 9.7%                       | 1,800             | 1,795                    | 6.3%                       |
| Media                                  | 180                     | 176                      | 0.6%                       | 168               | 165                      | 0.6%                       |
| Olivetti                               | 452                     | 400                      | 1.3%                       | 590               | 536                      | 1.9%                       |
| Other Activities(3)                    | 1,321                   | 316                      | 1.0%                       | 1,289             | 292                      | 1.0%                       |
| <b>Total revenues</b>                  | <b>32,763</b>           | <b>29,919</b>            | <b>100.0%</b>              | <b>31,278</b>     | <b>28,292</b>            | <b>100.0%</b>              |

(1) Gross revenues are total revenues of the various business units of the Telecom Italia Group before elimination of intercompany sales (but after elimination of sales between companies within the same major business area).

(2) Data include revenues recorded by each business area on a consolidated basis after elimination of intercompany sales.

(3) Other activities consist of the Central Functions (Group Functions and Service Units) and the foreign operations not included in other business units (the Entel Bolivia group). For further details on Other Activities please see Item 4. Information on the Telecom Italia Group 4.2 Business Units 4.2.7 Other Telecom Italia Group Activities .

The table below sets forth, for the periods indicated, revenues by geographical area and the percentage of total consolidated revenues:

| Geographical area                      | Year ended December 31, |       |        |       |
|--|-------------------------|-------|--------|-------|
|  | 2005                    |       | 2004   |       |
|  |                         |       |        |       |
| (millions of Euro, except percentages) |                         |       |        |       |
| Italy                                  | 23,754                  | 79.4% | 23,736 | 83.9% |
| Rest of Europe                         | 2,265                   | 7.6%  | 1,746  | 6.2%  |
| Latin America                          | 3,147                   | 10.5% | 2,036  | 7.2%  |
| Other Countries                        | 753                     | 2.5%  | 774    | 2.7%  |

|                                    |               |               |               |               |
|------------------------------------|---------------|---------------|---------------|---------------|
| <b>Total consolidated revenues</b> | <b>29,919</b> | <b>100.0%</b> | <b>28,292</b> | <b>100.0%</b> |
|------------------------------------|---------------|---------------|---------------|---------------|

V OTHER INCOME

**Other income** amounted to 678 million, a decrease of 421 million compared to 2004 1,099 million in 2004. The percentage of Other income to revenues was 2.3% in 2005 (3.9% in 2004).

Details are as follows:

|   | Year ended December 31, |              |
|---|-------------------------|--------------|
|   | 2005                    | 2004         |
|   | (millions of Euro)      |              |
| Compensation for late payment of regulated telephone services | 105                     | 85           |
| Release of provisions and other liabilities                   | 228                     | 162          |
| Recovery of costs of personnel and services rendered          | 56                      | 35           |
| Capital grants and grants related to income                   | 47                      | 64           |
| Damage compensations and penalties                            | 35                      | 32           |
| Income from release of prior year TLC operating fee           |                         | 546          |
| Other income  | 207                     | 175          |
| <b>Total</b>  | <b>678</b>              | <b>1,099</b> |

In 2004 the statement of income benefited from 546 million relating to the release of the TLC license operating fee paid by Telecom Italia and TIM for the year 1999, following the ruling by the TAR (the Regional Administrative Court) of Lazio on January 4, 2005.

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The table below sets forth, for the periods indicated, total consolidated **operating expenses** by major components and expressed as a percentage of total consolidated revenues.

|   | Year ended December 31,                |              |               |              |
|---|--|--------------|---------------|--------------|
|   | 2005                                   |              | 2004          |              |
|   | (millions of Euro, except percentages) |              |               |              |
| Purchases of materials and external services      | 12,937                                 | 43.2%        | 11,812        | 41.7%        |
| Personnel costs                                   | 4,142                                  | 13.9%        | 3,852         | 13.6%        |
| Other operating expenses                          | 1,468                                  | 4.9%         | 1,603         | 5.7%         |
| Changes in inventories                            | 4                                      |              | (27)          | (0.1)%       |
| Capitalized internal construction costs           | (471)                                  | (1.6)%       | (713)         | (2.5)%       |
| Depreciation and amortization                     | 5,232                                  | 17.5%        | 4,808         | 17.0%        |
| Gains/losses on disposals of non-current assets   | (242)                                  | (0.8)%       | 9             |              |
| Impairment reversals/losses on non-current assets | 28                                     | 0.1%         | 444           | 1.6%         |
| <b>Total operating expenses</b>                   | <b>23,098</b>                          | <b>77.2%</b> | <b>21,788</b> | <b>77.0%</b> |

Our operating expenses increased by 1,310 million in 2005 compared to 2004 which is detailed as follows:

- **Purchases of materials and external services** increased by 1,125 million (or 9.5%), from 11,812 million in 2004 to 12,937 million in 2005; the percentage of purchases of materials and external services to revenues was 43.2% (41.8% in 2004).

Purchases of materials and external services included:

|   | Year ended December 31, |              |
|---|-------------------------|--------------|
|   | 2005                    | 2004         |
|   | (millions of Euro)      |              |
| <b>Purchases of materials and merchandise for resale</b>    | <b>(A) 2,506</b>        | <b>2,203</b> |
| <b>Costs of services:</b>                                   |                         |              |
| - Revenues due to other TLC operators                       | 4,829                   | 4,241        |
| - Commissions, sales commissions and other selling expenses | 1,263                   | 1,006        |
| - Advertising and promotion expenses                        | 593                     | 504          |
| - Professional consulting and services                      | 530                     | 608          |

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|   |                   |                   |
|---|-------------------|-------------------|
| - Utilities   | 308               | 244               |
| - Maintenance   | 339               | 395               |
| - Outsourcing costs for other services  | 256               | 244               |
| - Mailing and delivery expenses for telephone bills, directories and other materials to customers | 90                | 64                |
| - Other service expenses  | 1,119             | 1,355             |
|   | <u>          </u> | <u>          </u> |
|   | <b>(B)</b>        | <b>9,327</b>      |
|   |                   | <b>8,661</b>      |
|   | <u>          </u> | <u>          </u> |
| <b>Lease and rental costs:</b>  |                   |                   |
| - Property lease rents  | 641               | 624               |
| - TLC circuit lease rents and rents for use of satellite systems                                  | 274               | 154               |
| - Other lease and rental costs  | 189               | 170               |
|   | <u>          </u> | <u>          </u> |
|   | <b>(C)</b>        | <b>1,104</b>      |
|   |                   | <b>948</b>        |
|   | <u>          </u> | <u>          </u> |
| <b>Total purchases of materials and external services</b>   | <b>(A+B+C)</b>    | <b>12,937</b>     |
|   |                   | <b>11,812</b>     |
|   | <u>          </u> | <u>          </u> |

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The principal reasons for the increase in Purchases of materials and external services were the following:

- purchases of materials and merchandise for resale increased by 303 million, or 13.8%, from 2,203 million in 2004 to 2,506 million in 2005. This increase was attributable, among other things, to sales of 3G handsets as the UMTS services were more broadly offered in 2005, as well as to innovative terminals (Aladino cordless phones and phones for video communication). The percentage of purchases of materials and merchandise for resale to revenues in 2005 was 8.4% (7.8% in 2004);
- costs of services increased by 666 million, or 7.7%, from 8,661 million in 2004 to 9,327 million in 2005. Such increase was attributable to a 588 million increase in revenues due to other TLC operators (increased from 4,241 million in 2004 to 4,829 million in 2005) and an increase of 257 million in Commissions, sales commissions and other selling expenses (increased from 1,006 million in 2004 to 1,263 million in 2005), principally as a result of the growth in mobile customers in 2005. These increases are partly offset by a 179 million net decrease in other expenses (from 3,414 million in 2004 to 3,235 million in 2005). The percentage of cost of services to revenues in 2005 was 31.2% (30.6% in 2004);
- lease and rental costs increased by 156 million, or 16.5%, of which 120 million was attributable to TLC circuit lease rents and rents for use of satellite systems. The percentage of lease and rental costs to revenues in 2005 was 3.7% (3.3% in 2004).
- **Personnel costs** increased by 290 million or 7.5% from 3,852 million in 2004 to 4,142 million in 2005. Such change was principally due to Charges for termination benefit incentive plans, which increased by 251 million in 2005. Excluding these charges personnel costs would have increased by 1.0%. The percentage of personnel costs to revenues was 13.8% in 2005 compared to 13.6% in 2004.

Personnel costs are detailed as follows:

|  | Year ended December 31, |              |
|--|-------------------------|--------------|
|  | 2005                    | 2004         |
|  | (millions of Euro)      |              |
| <b>Personnel costs at payroll:</b>   |                         |              |
| Wages and salaries   | 2,600                   | 2,595        |
| Social security contributions  | 813                     | 812          |
| Employee severance indemnities   | 168                     | 183          |
| Other employee-related costs   | 88                      | 64           |
|  | <b>(A)</b>              | <b>3,669</b> |
| <b>Temp work costs</b>   | <b>(B)</b>              | <b>52</b>    |
| <b>Miscellaneous expenses for personnel and for other labor-related services rendered:</b> |                         | <b>38</b>    |

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|   |                |                     |                     |
|---|----------------|---------------------|---------------------|
| Remuneration of personnel other than employees  |                | 18                  | 17                  |
| Charges for termination benefit incentive plans |                | 394                 | 143                 |
| Other   |                | 9                   |                     |
|   | (C)            | <u>421</u>          | <u>160</u>          |
| <b>Total personnel costs</b>                    | <b>(A+B+C)</b> | <b><u>4,142</u></b> | <b><u>3,852</u></b> |

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The Group's average equivalent number of employees in 2005 was 79,869 units (excluding employees related to discontinued operations/assets held for sale and including personnel with temp work contracts) compared to 79,602 units in 2004. The breakdown by category is as follows:

|   | Year ended December 31, |               |
|---|-------------------------|---------------|
|   | 2005                    | 2004          |
|   | (Units)                 |               |
| Executives                                | 1,541                   | 1,592         |
| Middle management                         | 4,744                   | 4,597         |
| White collars                             | 70,375                  | 70,540        |
| Blue collars                              | 722                     | 920           |
| <b>Total employees at payroll</b>         | <b>77,382</b>           | <b>77,649</b> |
| <b>Personnel with temp work contracts</b> | <b>2,487</b>            | <b>1,953</b>  |
| <b>Total employees</b>                    | <b>79,869</b>           | <b>79,602</b> |

- **Other operating expenses** decreased by 135 million (or 8.4%), from 1,603 million in 2004 to 1,468 million in 2005. Such operating expenses consist of the following:

|   | Year ended December 31, |              |
|---|-------------------------|--------------|
|   | 2005                    | 2004         |
|   | (millions of Euro)      |              |
| Impairments and charges for bad debts         | 521                     | 498          |
| Provision for risks and charges               | 71                      | 289          |
| TLC operating fees                            | 181                     | 114          |
| Taxes on revenues of South American companies | 178                     | 112          |
| Duties and indirect taxes                     | 141                     | 153          |
| Association fees and dues                     | 19                      | 18           |
| Other expenses                                | 357                     | 419          |
| <b>Total other operating expenses</b>         | <b>1,468</b>            | <b>1,603</b> |

The decrease in Other operating expenses was mainly due to the reduction of 218 million in Provision for risks and charges (71 million in 2005 and 289 million in 2004). In 2004 Provisions for risks and charges included 152 million recorded against the fine levied by the Antitrust Authority for the alleged abuse of a dominant position in the market.



**Capitalized internal construction costs** include sales of equipment, installations and services at market prices by Group companies, principally to Telecom Italia and Domestic Mobile. These costs decreased by 242 million (or 33.9%), from 713 million in 2004 to 471 million in 2005, and consist of the following:

|  | Year ended December 31, |            |
|--|-------------------------|------------|
|  | 2005                    | 2004       |
|  | (millions of Euro)      |            |
| <b>Capitalized internal construction costs on:</b>   |                         |            |
| Intangible assets with a finite life                 | 287                     | 522        |
| Property, plant and equipment owned                  | 184                     | 191        |
| <b>Total capitalized internal construction costs</b> | <b>471</b>              | <b>713</b> |

The reduction in 2005 compared to 2004 was due to the fact that in 2004, the external costs relating to contracts that had to be capitalized were recorded in the statement of income, whereas, in 2005, such costs were booked directly to the capital asset account.

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- **Depreciation and amortization** increased by 424 million (or 8.8%), from 4,808 million in 2004 to 5,232 million in 2005; the percentage of depreciation and amortization to revenues was 17.5% (17.0% in 2004).

Depreciation and amortization are detailed as follows:

|  | Year ended December 31, |              |
|--|-------------------------|--------------|
|  | 2005                    | 2004         |
| (millions of Euro)   |                         |              |
| <b>Amortization of Intangible assets with a finite life:</b>     |                         |              |
| Industrial patents and intellectual property rights              | 1,414                   | 1,106        |
| Concessions, licenses, trademarks and similar rights             | 253                     | 224          |
| Other intangible assets  | 17                      | 16           |
|  | <b>(A) 1,684</b>        | <b>1,346</b> |
| <b>Depreciation of tangible assets owned:</b>                    |                         |              |
| Civil and industrial buildings                                   | 103                     | 103          |
| Plant and equipment  | 2,910                   | 2,869        |
| Manufacturing and distribution equipments                        | 31                      | 27           |
| Aircrafts and ships  | 9                       | 12           |
| Other assets   | 363                     | 313          |
|  | <b>(B) 3,416</b>        | <b>3,324</b> |
| <b>Depreciation of tangible assets held under finance lease:</b> |                         |              |
| Civil and industrial buildings                                   | 93                      | 93           |
| Plant and equipment  | 1                       |              |
| Aircrafts and ships  | 4                       | 4            |
| Other assets   | 34                      | 41           |
|  | <b>(C) 132</b>          | <b>138</b>   |
| <b>Total depreciation and amortization</b>                       | <b>(A+B+C) 5,232</b>    | <b>4,808</b> |

The increase in Depreciation and amortization of 424 million was in part due to the higher levels of amortizable assets (in particular Industrial patents and intellectual property rights) as a result of the higher investments made in 2004 and 2005.

- **Gains/losses on disposals of non-current assets** changed from a net loss of 9 million in 2004 to a net gain of 242 million in 2005. In particular, in 2005, such item included the gains, net of incidental charges, of 264 million realized by the contribution of 561 properties to the closed-end fund Fondo Raissa and 246 properties to the closed-end fund Fondo spazio industriale. Such transactions were executed as part of the Group's continuing real estate disposal program.

- **Impairment losses of non current assets** decreased by 416 million or 93.7%, from a loss of 444 million in 2004 to a loss of 28 million in 2005. In 2004, such item included 282 million related to the De Agostini transaction for the purchase of 40% of Finanziaria Web, as well as provisions and impairment losses of intangible and tangible assets ( 162 million).

V **OPERATING INCOME**

**Operating income** decreased by 104 million, or 1.4%, from 7,603 million in 2004 to 7,499 million in 2005. As a percentage of revenues, operating income was 25.1% in 2005 (26.9% in 2004).

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V **SHARE OF PROFITS (LOSSES) OF ASSOCIATES AND JOINT VENTURES ACCOUNTED FOR USING THE EQUITY METHOD**

The **Share of profits (losses) of associates and joint ventures accounted for using the equity method** was a profit of 23 million in 2005 (loss of 5 million in 2004), an increase of 28 million compared to 2004.

This item includes:

|   | Year ended December 31, |            |
|---|-------------------------|------------|
|   | 2005                    | 2004       |
|   | (millions of Euro)      |            |
| ETECSA.   | 45                      | (6)        |
| Sofora Telecomunicaciones S.A   | 16                      |            |
| Solpart Participações S.A.  | 94                      |            |
| Avea I.H.A.S.   | (122)                   |            |
| Other investments   | (10)                    | 1          |
| <b>Total share of profits (losses) of associates and joint ventures accounted for using the equity method</b> | <b>23</b>               | <b>(5)</b> |

In particular:

- 45 million related to the Group's share of income for 2005 of ETECSA (the operator of the Cuban telecommunications system); during 2004, the positive adjustment to ETECSA's equity was more than offset by the impairment of goodwill;
- 16 million related to Sofora Telecomunicaciones, the company through which Telecom Italia holds its interest in Telecom Argentina, mainly due to the significant result achieved by Telecom Argentina at the conclusion of the debt restructuring plan (at the end of August 2005) and following the positive effect on shareholder's equity. The debt restructuring followed Telecom Argentina's default on its obligations in 2001 on account of the monetary crisis in Argentina;
- 94 million related to restoring the equity method of accounting for the investment in Solpart Participações through which Telecom Italia holds its interest in Brasil Telecom. Following the agreements signed on April 28, 2005, Telecom Italia reinstated its governance rights in Solpart Participações, which had been temporarily suspended since August 2002, resuming its role in the management of the company;
- the loss of 122 million relating to Avea I.H.A.S. (the group's then mobile operations in Turkey) related to the Group's share of the loss for 2005 of such associate. In 2004, the share of the loss had not been recognized as the investment was carried at zero value.

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For further details about the above mentioned equity investments accounted for using the equity method please see Item 4. Information on the Telecom Italia Group 4.2 Business Units 4.2.7 Other Telecom Italia Group Activities , and Note 8 Other Non Current Assets of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report.

### V FINANCIAL INCOME AND EXPENSES, NET

**Total financial income and expenses** showed a net expense balance of 1,987 million (a net expense balance of 1,992 million in 2004), representing an improvement of 5 million compared to 2004.

Net financial income and expense are detailed as follows:

|                                    | Year ended December 31, |         |
|------------------------------------|-------------------------|---------|
|                                    | 2005                    | 2004    |
|                                    | (millions of Euro)      |         |
| Financial management balance (*)   | (2,505)                 | (2,204) |
| Investment management              | 95                      | 212     |
| Avea provisions released to income | 423                     |         |
|                                    | (1,987)                 | (1,992) |

(\*) It refers mainly to net interest expenses and other borrowing costs, foreign exchange gains and losses, and income and expenses from hedging and non-hedging derivatives.

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The main changes are due to:

- the release of provisions for 423 million booked in respect of sureties issued to the banks which had financed the associate Avea, since there is no longer a risk following the cancellation of the guarantees;
- the decrease in the net amount of income from the management of investments of 117 million, which in 2004 had benefited from the gains realized in connection with the sale of the remaining investment in Telekom Austria ( 86 million) as well as gains from the sale of the remaining stake in Mirror International ( 85 million). In 2005, gains were realized on the sale of the investment in C-Mobil by the Mobile Business Unit ( 61 million), the sale of the investment in Intelsat by Entel Bolivia ( 2 million) and the sale of the investment in Golden Lines by Telecom Italia International ( 5 million);
- the reduction in the balance of financial management is mainly due to disbursements made for the purchase of TIM shares in the early months of the year through the Cash Tender Offer and other purchases on the market which had an impact in terms of both higher debt exposure and lower liquidity.

For further details about financial income and expenses, net please see Note 36 Financial income and Note 37 Financial expenses , respectively, of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report.

**V INCOME FROM CONTINUING OPERATIONS BEFORE TAXES**

**Income from continuing operations before taxes** decreased by 71 million, from 5,606 million in 2004 to 5,535 million in 2005.

As a percentage of revenues, income from continuing operations before taxes was 18.5% in 2005 (19.8% in 2004).

**V INCOME TAXES**

**Income taxes** in 2005 decreased by 259 million, or 9.8%, from 2,654 million in 2004 to 2,395 million in 2005.

Besides the decrease in taxable income, the reduction of 259 million was due to the realignment made by Tim Italia, ex art. 1, paragraph 469, Law No. 266/2005 and ex art. 14, Law No. 342/2000, of the figures in the statutory financial statements with the tax figures, the latter being lower as a result of accelerated depreciation and the amortization of the UMTS license on which tax interference had already been eliminated in the 2004 financial statements of TIM. This realignment led to a provision for equalization tax of 43 million and the reduction in the reserve for deferred taxes of 135 million.

The percentage of income taxes to revenues was 8.0% in 2005 (9.4% in 2004).

V **NET INCOME FROM CONTINUING OPERATIONS**

**Net income from continuing operations** increased by 188 million, or 6.4%, from 2,952 million in 2004 to 3,140 million in 2005. Although income from continuing operations before taxes decreased by 71 million from 5,606 million in 2004 to 5,535 million in 2005, such increase was attributable to the 259 million decrease in income taxes due to the reasons discussed above.

The percentage of net income from continuing operations to revenues was 10.5% in 2005 (10.4% in 2004).

V **NET INCOME (LOSS) FROM DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE**

**Net income from discontinued operations/assets held for sale** increased in 2005 by 668 million, from a net loss of 118 million in 2004 to a net income of 550 million in 2005.

This item in 2005 included:

- 410 million gain (net of related incidental charges) from the sale of Tim Hellas;
- 120 million gain (net of related incidental charges) from the sale of Tim Perù;

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- 24 million loss (including incidental charges) from the sale of the Entel Chile group, Finsiel group and Gruppo Buffetti. During 2004, net loss from discontinued operations/assets held for sale included: the impairment loss on the goodwill related to Entel Chile ( 177 million), the provision related to Finsiel group for the adjustment to the estimated sale price ( 28 million) and other provisions related to companies held for sale ( 14 million), mainly relating to Entel Chile group;
- 44 million related to net results of the companies classified as discontinued operations/assets held for sale including:
  - net income of 26 million related to the Entel Chile group, consolidated for the first three months of 2005 (net income of 49 million in 2004);
  - net loss of 11 million related to the Finsiel group, consolidated for the first six months of 2005 (net loss of 7 million in 2004);
  - net income of 11 million related to Tim Hellas, consolidated for the first five months of 2005 (net income of 82 million in 2004);
  - net loss of 3 million relating to Tim Perù, consolidated for to the first seven months of 2005 (net loss of 17 million in 2004);
  - net income of 1 million relating to Gruppo Buffetti (unchanged compared to 2004);
  - net income of 20 million relating to Digital Venezuela (net loss of 7 million in 2004).

**V NET INCOME FOR THE YEAR**

**Net income for the year** 2005 increased by 856 million, or 30.2%, from 2,834 million in 2004 to 3,690 million in 2005. As a percentage of revenues, net income for the year was 12.3% in 2005 (10.0% in 2004).

Such increase was principally due to lower income taxes on income from continuing operations ( 259 million), as well as the increase of Net income from discontinued operations / assets held for sale ( 668 million).

Net income for the year is broken down as follows:

- net income attributable to equity holders of the Parent in 2005 was 3,216 million compared with 1,815 million in 2004, showing an increase of 1,401 million;
-



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net income attributable to Minority Interests was 474 million in 2005 compared with 1,019 million in 2004, showing a decrease of 545 million, mainly due to the acquisition by Telecom Italia of the minority interests in TIM.

### 5.5.8 RESULTS OF OPERATIONS OF BUSINESS UNITS FOR THE YEAR ENDED DECEMBER 31, 2005 COMPARED WITH THE YEAR ENDED DECEMBER 31, 2004.

#### V OPERATIONS

In order to present an overall picture of Operations, the following table shows the key results for the year ended December 31, 2005, compared to the year ended December 31, 2004. All the data have been reclassified and presented consistent with the 2006 presentation.

| <u>Operations</u>               | <u>Year ended December 31,</u>                       |             |
|---------------------------------|--|-------------|
|                                 | <u>2005</u>  | <u>2004</u> |
|                                 | (millions of Euro, except percentages and employees) |             |
| Gross revenues                  | 29,096   | 27,383      |
| Operating income                | 8,144  | 8,540       |
| % of gross revenues             | 28.0   | 31.2        |
| Number of employees at year-end | 77,754   | 74,576      |

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**Gross Revenues** increased by 1,713 million, or 6.3%, from 27,383 million in 2004 to 29,096 million in 2005.

**Operating income** decreased by 396 million, or 4.6% from 8,540 million in 2004 to 8,144 million in 2005.

A commentary on the operating and financial performance and the principal activities carried out during 2005 and 2004 by Operations (Wireline, Domestic Mobile and Brazil Mobile) follows.

**v WIRELINE**

The following table sets forth, for the periods indicated, certain financial and other data for the Wireline Business Unit.

| <b>Wireline</b>                 | <b>Year ended December 31,</b>                              |                |
|---------------------------------|---|----------------|
|                                 | <b>2005(1)</b>  | <b>2004(1)</b> |
|                                 | <b>(millions of Euro, except percentages and employees)</b> |                |
| Gross revenues                  | 17,834  | 17,508         |
| Operating income                | 4,488   | 4,709          |
| % of gross revenues             | 25.2  | 26.9           |
| Number of employees at year-end | 56,987  | 55,833         |

(1) As a result of the new organizational structure of the Group approved on October 5, 2005, the activities of the Innovation & Engineering Services business segment of Telecom Italia, ex-TILAB segment of Telecom Italia, previously included in Other activities, were transferred to the Wireline Business Unit, therefore 2005 and 2004 results have been reclassified for purposes of comparison.

The following table sets forth, for the periods indicated, certain statistical data for Wireline.

|                                     | <b>As of and for the year ended December 31,</b> |             |
|-------------------------------------|--|-------------|
|                                     | <b>2005</b>                                      | <b>2004</b> |
| <b>Subscriptions and Customers:</b> |  |             |

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|   |              |              |
|---|--------------|--------------|
| Fixed network connections in Italy (thousands)(1)                                 | 25,049       | 25,957       |
| Physical Accesses (Consumer + Business) (thousands)                               | 21,725       | 22,395       |
| Voice Pricing Plans (thousands)(2)  | 6,321        | 5,883        |
| Broadband Accesses (thousands)(3):  | 7,020        | 4,430        |
| • Domestic (thousands)  | 5,707        | 4,010        |
| • European, other than domestic (thousands)                                       | 1,313        | 420          |
| Alice Page views (ex-Virgilio) (millions)   | 9,842        | 7,902        |
| Alice (ex-Virgilio) average monthly single visitors (millions)                    | 15.7         | 13.9         |
| <b>Network infrastructure in Italy:</b>   |              |              |
| Access network in copper (millions of km-pair)                                    | 105.2        | 105.2        |
| Access network and transport in optical fibers (millions of km of optical fibers) | 3.7          | 3.7          |
| <b>Network infrastructure outside Italy:</b>                                      |              |              |
| European backbone (km of optical fibers)  | 51,000       | 39,500       |
| <b>Wireline Traffic:</b>  |              |              |
| Wireline total traffic (Retail and Wholesale) (billions of minutes)               | 185.1        | 192.0        |
| <i>of which:</i>  |              |              |
| <i>Domestic</i>   | <i>171.3</i> | <i>179.1</i> |
| <i>International</i>  | <i>13.8</i>  | <i>12.9</i>  |

(1) Data exclude internal lines.

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

(3) Number of contracts.

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**Gross Revenues** increased by 326 million, or 1.9%, from 17,508 million in 2004 to 17,834 million in 2005.

The increase in gross revenues was largely due to the success of efforts to develop the Broadband market and innovative services, particularly Web services, and to further develop the European Broadband Project, together with efforts to defend the core Wireline market for telephone services and enhance the range of wholesale services.

Wireline tracks revenues in the following business areas: Retail Telephone, Retail Internet, Data Business, Wholesale and European Broadband Project.

- **Retail Telephone.** Revenues from Retail Telephone were 10,095 million in 2005, a decrease of 496 million, or 4.7% from 10,591 million in 2004.

This business area was marked by a decrease in traffic revenues due to the migration of volumes to the mobile network, partly due to competitive on-net rates (mobile to mobile calls between customers of the same operator), countered by the continuous growth of Value-Added Services (VAS) and the rapid spread of innovative handsets.

- **Retail Internet.** Revenues from Retail Internet were 1,197 million in 2005, an increase of 176 million, or 17.2% from 1,021 million in 2004. Revenues from ADSL (including revenues from portal services) were approximately 865 million, increasing strongly by 40% compared to 2004 (618 million in 2004), mainly due to the larger customer base and traffic. Revenues from Internet dial-up traffic decreased from 403 million in 2004 to 332 million in 2005 due to migration to Internet connections using broadband access.
- **Data Business.** Revenues from Data Business were 2,107 million in 2005, an increase of 125 million, or 6.3% from 1,982 million in 2004.

The growth in services revenues was driven mainly by value added services (web services, outsourcing and security services) and by innovative data services: VAS increased by 25.3% in 2005 compared to 2004 (550 million in 2005 and 439 million in 2004); innovative data services increased by 15.7% in 2005 compared to 2004 (723 million in 2005 and 625 million in 2004). Revenues from traditional Data services (data transmission using data packet technology) and leased lines decreased from 620 million in 2004 to 553 million in 2005 (a decrease of 10.8%), mainly due to customer migration to broadband services and repricing. Revenue from Data equipment decreased to 281 million in 2005 from 298 million in 2004 (a decrease of 5.7%).

- **Wholesale.** Revenues from Wholesale were 3,526 million in 2005, an increase of 337 million, or 10.6% compared to 2004 (3,189 million in 2004).

Revenues from International Wholesale services increased by 240 million or 18% due to significant volumes of traffic carried to other operators, while revenues from Domestic Wholesale services increased by 96 million or 5.1% due to continued growth in Data offers, especially broadband, and LLU services.

- **European Broadband Project.** Revenues from the European Broadband Project (France, Germany and The Netherlands) were 565 million in 2005 an increase of 109.6% compared to 2004. The European Broadband Project was given a further boost in growth by the purchase of Liberty Surf Group in France on May 31, 2005. Wireline's overall portfolio of European broadband customers at December 31, 2005 was 1,313 thousand (an increase of 893 thousands compared to 2004), while total customers, including narrow-band, were 1,791 thousand.

The contribution of the Wireline Business Unit to our consolidated revenues amounted to 15,843 million in 2004 and 16,356 million in 2005.

**Operating income** decreased by 221 million, or 4.7%, from 4,709 million in 2004 to 4,488 million in 2005, and was negatively impacted, among other things, by an increase in depreciation and amortization charges mainly as a result of the increase in capital expenditures for the European Broadband Project.

**Operating margin** decreased to 25.2% in 2005 compared to 26.9% in 2004.

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The following table sets forth, for the periods indicated, certain financial and other data for Domestic Mobile.

In particular, the 2005 data refer to ex-TIM S.p.A. up to the date of the demerger of the mobile activities to Tim Italia S.p.A. (March 1, 2005) and Tim Italia S.p.A. in the period March December 2005. The 2004 data refer to ex-TIM S.p.A.

| <b>Domestic Mobile</b>          | <b>Year ended December 31,</b>                             |             |
|---------------------------------|--|-------------|
|                                 | <b>2005</b>  | <b>2004</b> |
|                                 | <b>(millions of Euro, except percentage and employees)</b> |             |
| Gross revenues                  | 10,076   | 9,923       |
| Operating income                | 3,856  | 4,010       |
| % of gross revenues             | 38.3   | 40.4        |
| Number of employees at year-end | 11,720   | 11,767      |

The following table sets forth, for the periods indicated, certain Domestic Mobile statistical data.

|  | <b>Year ended December 31,</b> |             |
|--|--------------------------------|-------------|
|  | <b>2005</b>                    | <b>2004</b> |
| Mobile telephone lines in Italy at year-end (thousands)(1)                 | 28,576                         | 26,259      |
| GSM subscriber lines (thousands)   | 3,186                          | 2,809       |
| Prepaid GSM/UMTS lines (thousands)   | 25,296                         | 23,226      |
| Customer growth (%)  | 8.8                            | 0.7         |
| Churn rate (2)   | 16.9                           | 13.2        |
| Average monthly revenues per line ( ) (3)                                  | 29.3                           | 29.9        |
| Total Mobile outgoing traffic per month (millions of minutes)              | 2,314                          | 2,211       |
| Total Mobile incoming and outgoing traffic per month (millions of minutes) | 3,550                          | 3,435       |

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

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(2) The figures refer to the total number of lines. The churn rate for a given period represents the number of mobile customers who ceased to be customers during the period (by choice or due to unpaid bills) expressed as a percentage of the average number calculated on the basis of the annual numbers of customers during the period.

(3) Includes total revenues from fees, traffic (domestic and not) and VAS, excluding revenues from the sale of products.

**Gross revenues** in 2005 increased by 153 million, or 1.5%, from 9,923 million in 2004 to 10,076 million in 2005. In particular, the increase in revenues was principally due to the strong growth in VAS revenues to 1,497 million, due to the continuing innovation of services and the evolution of the portfolio of plans and packages. The percentage of VAS revenues to total revenues was 14.9% in 2005 and the percentage of VAS revenues to service revenues was 16.0% in 2005.

In 2005, Domestic Mobile traffic volumes increased by 3.3% in terms of minutes compared to 2004, while Domestic Mobile voice services revenues, net of the impact of the new termination price list, decreased by 0.1% in 2005 compared to 2004. The average monthly revenue per Italian mobile line (which includes traffic and VAS revenues) decreased from approximately 29.9 in 2004 to 29.3 in 2005 (including service revenues from non TIM Mobile customers).

Domestic Mobile revenues from equipment sales increased by 23.9% in 2005 compared to 2004 ( 706 million against 570 million in 2004). In particular handset volumes increased by 26% due to summer and Christmas advertising and the launch of EDGE/UMTS services.

Domestic Mobile subscription fees decreased by 24.4% in 2005 compared to 2004 ( 99 million in 2005 against 131 million in 2004) due to a change in contractual conditions, in order to reach a rebalancing among subscription fees and tariffs.

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The contribution of the Domestic Mobile Business Unit to our consolidated revenues amounted to 9,661 million in 2004 and 9,776 million in 2005.

Mobile lines in Italy increased to approximately 28.6 million at December 31, 2005 (including TACS lines), an increase of 8.8% compared to December 31, 2004. Total GSM and UMTS lines increased by 9.4% in 2005, to approximately 28.5 million lines at December 31, 2005, while Domestic Mobile Italy's total TACS lines decreased to 94,000 lines at December 31, 2005, in each case compared to December 31, 2004. TACS service terminated on December 31, 2005. The continuing growth in GSM/UMTS lines was attributable principally to the development of UMTS service offers and the enhanced availability of third generation handsets. The UMTS and GSM TIM Card (a prepaid rechargeable UMTS and GSM card), remained important with approximately 25.3 million lines by December 31, 2005 compared to approximately 23.2 million lines at December 31, 2004. Prepaid lines (GSM/UMTS and TACS) grew by 8.4% in 2005.

At December 31, 2005, Domestic Mobile had a market share of approximately 40.0% (including GSM/UMTS and TACS) compared to the approximately 42% at December 31, 2004, and a market share of approximately 39.9% for GSM/UMTS only compared to 41.4% in 2004. The overall market grew by 13.2% in 2005 from approximately 63.2 million mobile lines at the end of 2004 to 71.5 million mobile lines at the end of 2005. The aggregate number of customers at December 31, 2005 for Domestic Mobile's analog and GSM/UMTS services represented a penetration rate of 49.1% compared to 45.5% at December 31, 2004. In 2005, Domestic Mobile had a 29.0% market share of net additional GSM/UMTS lines, corresponding to 2.4 million of net lines, compared to 1.6 million for Vodafone Omnitel, 1.6 million for Wind and the remaining 2.8 million attributable to H3G.

**Operating income** decreased by 154 million, or 3.8%, from 4,010 million in 2004 to 3,856 million in 2005. Such decrease reflected the significant increase in depreciation and amortization charges due to recent investments for the development of third-generation network infrastructures and to support the evolution of plans and packages for new services.

**Operating margin** decreased to 38.3% in 2005 compared to 40.4% in 2004.

**V BRAZIL MOBILE**

The following table sets forth, for the periods indicated, certain financial and other data for the Brazil Mobile Business Unit.

|                      | Year ended December 31,                             |       |
|----------------------|---|-------|
|                      | 2005  | 2004  |
| <b>Brazil Mobile</b> |   |       |
|                      | (millions of Euro, except percentage and employees) |       |
| Gross revenues       | 2,900   | 1,800 |
| Operating loss       | (190)   | (137) |



|                                 |       |       |
|---------------------------------|-------|-------|
| % of gross revenues             | (6.5) | (7.6) |
| Number of employees at year-end | 9,043 | 6,967 |

**Gross revenues** were 2,900 million in 2005 compared to 1,800 million in 2004, an increase of 1,100 million, or 61.1%. The increase was due to the growth in the customer base (20.2 million mobile lines at December 31, 2005 compared to 13.6 million mobile lines at December 31, 2004), the contribution made by value-added services (which rose from 3.2% of revenues in 2004 to 5.0% in 2005) and revenues from voice traffic.

The contribution of Brazil Mobile Business Unit to our consolidated revenues amounted to 1,795 million in 2004 and 2,895 million in 2005.

**Operating loss** in 2005 was 190 million compared to 137 million in 2004, an increase of 53 million. The increased loss was due to the increase in depreciation and amortization mainly related to the capital expenditures for the development of network infrastructures and information systems consistent with the significant growth in the business.

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The following table sets forth, for the periods indicated, certain financial and other data for the Media Business Unit.

| <b>Media</b>                    | <b>Year ended December 31,</b>                      |             |
|---------------------------------|---|-------------|
|                                 | <b>2005</b>   | <b>2004</b> |
|                                 | (millions of Euro, except percentage and employees) |             |
| Gross revenues                  | 180   | 168         |
| Operating loss                  | (130)   | (93)        |
| % of gross revenues             | (72.2)  | (55.4)      |
| Number of employees at year-end | 886   | 1,077       |

**Gross revenues** increased by 12 million, or 7.1%, from 168 million in 2004 to 180 million in 2005. Excluding the impact of the change in the scope of consolidation (with reference to GPP Group, Televoice and Databank) equal to 24 million in 2004, as well as the start-up activities relating to the Digital Terrestrial Television of La7 (sales of pay-per-view events and smart cards) equal to 10 million in 2005, growth was 24 million, or 16.7%, from 144 million in 2004 to 168 million in 2005. In particular:

- revenues from the Television business area, including revenues for Digital Terrestrial Television, increased by 35 million, or 25.4%, from 138 million in 2004 to 173 million in 2005, confirming the editorial success of the program schedule of the two TV networks:
  - revenues from La7 Televisioni, increased by 40.3%, from 62 million in 2004 to 87 million in 2005; and
  - revenues from MTV, increased by 16.2%, from 80 million in 2004 to 93 million in 2005;
- revenues from the News area, equal to 7 million in 2005 and 5 million in 2004, increased by 2 million, or 40.0%.

The contribution of the Media Business Unit to our consolidated revenues amounted to 176 million in 2005 and 165 million in 2004.

**Operating loss** increased by 37 million (a loss of 130 million in 2005 compared to a loss of 93 million in 2004). Such increase was principally due to the Television area where losses increased by 41 million, from a loss of 60 million in 2004 to a loss of 101 million

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in 2005, mainly due to higher costs incurred for digital terrestrial testing during 2005. Moreover, operating loss was affected by higher costs and investments in content required to support audience growth.

V OLIVETTI

The following table sets forth, for the periods indicated, certain financial and other data for the Olivetti Business Unit.

| Olivetti                        | Year ended December 31,                             |       |
|---------------------------------|---|-------|
|                                 | 2005  | 2004  |
|                                 | (millions of Euro, except percentage and employees) |       |
| Gross revenues                  | 452   | 590   |
| Operating income (loss)         | (38)  | 17    |
| % of gross revenues             | (8.4)   | 2.9   |
| Number of employees at year-end | 1,750   | 2,109 |

**Gross revenues** decreased by 138 million, or 23.4%, from 590 million in 2004 to 452 million in 2005. Excluding the negative foreign exchange effects and the impact of the change in the scope of consolidation (with

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particular reference to the closing of operations in the U.S.A. and Mexico and the sale of Innovis S.p.A. and Cell-Tel S.p.A.) which represented 70 million in revenues, the revenues from the sale of intellectual property to Telecom Italia for 9 million and revenues from the start-up activities relating to the new products of the Office Division for 4 million, revenues decreased by 81 million (or 15.3%). Such decrease, in particular, was due to the decrease from Office Division (a decrease of 56 million), and Gaming and Service Automation & Specialized Printers Products (a decrease of 23 million).

In 2005, gross revenues included 256 million from Office Products, 157 million from Gaming and Service Automation & Specialized Printers Products, 36 million from the sale of intellectual property to Telecom Italia and 3 million related to other activities. Such revenues were distributed as follows: 266 million related to hardware, 101 million to accessories, 85 million to services and other revenues.

The contribution of the Olivetti Business Unit to our consolidated revenues was 400 million in 2005 and 536 million in 2004.

**Operating income** decreased by 55 million (a loss of 38 million in 2005 compared to an income of 17 million in 2004) principally due to the above mentioned decrease in revenues.

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**5.6 LIQUIDITY AND CAPITAL RESOURCES****5.6.1 LIQUIDITY**

The Telecom Italia Group's primary source of liquidity is cash generated from operations and its principal uses of funds are the payment of operating expenses, capital expenditures and investments, the servicing of debt, the payment of dividends to shareholders and strategic investments, such as international acquisitions.

The table below summarizes, for the periods indicated, the Telecom Italia Group's cash flows.

|  | 2006               | 2005         | 2004         |
|--|--------------------|--------------|--------------|
|  | (millions of Euro) |              |              |
| Cash flows generated by (used in) operating activities                                 | 9,194              | 9,778        | 10,266       |
| Cash flows generated by (used in) investing activities                                 | (4,191)            | (17,421)     | (4,951)      |
| Cash flows generated by (used in) financing activities                                 | (7,972)            | 8,767        | (1,714)      |
| Cash flows generated by (used in) discontinued operations/assets held for sale         | (13)               | 26           | (109)        |
| <b>Aggregate cash flows (A)</b>  | <b>(2,982)</b>     | <b>1,150</b> | <b>3,492</b> |
| <b>Net cash and cash equivalents (*) at the beginning of the year (B)</b>              | <b>9,958</b>       | <b>8,667</b> | <b>5,211</b> |
| <b>Net effect of foreign currency translation on net cash and cash equivalents (C)</b> | <b>(16)</b>        | <b>141</b>   | <b>(36)</b>  |
| <b>Net cash and cash equivalents (*) at the end of the year (D=A+B+C)</b>              | <b>6,960</b>       | <b>9,958</b> | <b>8,667</b> |

(\*) For details please see Consolidated Statements of Cash Flows for the years ended December 31, 2006, 2005 and 2004, in the Consolidated Financial Statements included elsewhere in this Annual Report.

*Cash flows generated by operating activities.* Cash flows generated by operating activities were 9,194 million in 2006, 9,778 million in 2005 and 10,266 million in 2004.

**2006 compared to 2005**

The decrease in 2006 compared to 2005 of 584 million was primarily attributable to:

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- a reduction of 144 million of net income from continuing operations (income of 2,996 million in 2006 compared to income of 3,140 million in 2005);
- the negative effect of change in employee severance indemnities and other employee-related provisions of 369 million (a negative contribution of 114 million in 2006 compared to a positive contribution of 255 million in 2005);
- the negative effect of change in trade receivables and net receivables on construction contracts of 790 million (a negative contribution of 461 million in 2006 compared to a positive contribution of 329 million in 2005);
- the negative effect of change in trade payables of 194 million (a negative contribution of 10 million in 2006 compared to a positive contribution of 184 million in 2005).

Such negative effects were partially offset by:

- an increase in depreciation and amortization of 255 million ( 5,487 million in 2006 compared to 5,232 million in 2005);
- an additional decrease in net deferred tax assets, equal to 496 million (to a reduction of 1,843 million in 2006 compared to a reduction of 1,347 million in 2005);
- a positive effect of net change in miscellaneous receivables/payables and other assets/liabilities of 177 million (a negative effect of 180 million in 2006 compared to a negative effect of 357 million in 2005).

### **2005 compared to 2004**

The decrease in 2005 compared to 2004 of 488 million was primarily attributable to:

- the decrease in net impairment losses of non-current assets (including investments) of 443 million ( 3 million of losses in 2005 compared to 446 million of losses in 2004);

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- the increase in net gains realized on disposals of non-current assets (including investments) of 221 million (a net gain of 327 million in 2005 compared to a net gain of 106 million in 2004);
- the negative effect of change of trade payables of 895 million (an increase of 184 million in 2005 compared to an increase of 1,079 million in 2004);
- the decrease in share of (profits) losses of associates and joint ventures accounted for using the equity method of 28 million (net profits of 23 million in 2005 compared to net losses of 5 million in 2004);
- a negative effect of net change in miscellaneous receivables/payables and other assets/liabilities of 327 million (a negative contribution of 357 million in 2005 compared to a negative contribution of 30 million in 2004).

Such negative effects were mainly offset by:

- an increase of 188 million in net income from continuing operations (income of 3,140 million in 2005 compared to income of 2,952 million in 2004);
- an increase in depreciation and amortization of 424 million (5,232 million in 2005 compared to 4,808 million in 2004);
- an additional decrease in net deferred tax assets equal to 223 million (a reduction of 1,347 million in 2005 compared to a reduction of 1,124 million in 2004);
- the positive effect of change in employee severance indemnities and other employee-related provisions of 294 million (an increase of 255 million in 2005 compared to a decrease of 39 million in 2004);
- the positive effect of change in trade receivables and net receivables on construction contracts of 278 million (a positive contribution of 329 million in 2005 compared to a positive contribution of 51 million in 2004).

*Cash flows used in investing activities.* Cash flows used in investing activities were 4,191 million in 2006, 17,421 million in 2005 and 4,951 million in 2004.

**2006 compared to 2005**

The decrease in 2006 compared to 2005 of 13,230 million was mainly due to:

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a decrease in acquisitions of investments in subsidiaries and businesses, net of cash acquired, of 390 million (no acquisitions occurred in 2006 compared to acquisitions of 390 million in 2005 that were principally related to the purchase of the controlling interest in Liberty Surf Group and the acquisitions of Elefante TV and Delta TV);

- a decrease in acquisitions of other investments of 14,338 million related to acquisitions of 206 million in 2006 compared to acquisitions of 14,544 million in 2005 (such amount was mainly due to the consideration paid for the tender offer for the TIM shares and the further purchases of TIM in connection with acquiring the Minority Interests in TIM);
- a positive effect of change in financial receivables and other financial assets of 210 million (a negative contribution of 264 million in 2006 compared to a negative contribution of 474 million in 2005);
- an increase in proceeds from sale/repayments of intangible, tangible and other non-current assets of 88 million (a positive contribution of 1,038 million in 2006 compared to a positive contribution of 950 million in 2005);
- a decrease in capital expenditures on an accrual basis of 59 million ( 5,114 million in 2006 compared to 5,173 million in 2005). In 2006 capital expenditures included 2,187 million for acquisitions of intangible assets ( 1,785 million in 2005) and 2,927 million for acquisitions of tangible assets ( 3,388 million in 2005).

Such positive effects were offset by:

- a negative effect of change in amounts due to fixed asset suppliers of 148 million (a positive contribution of 10 million in 2006 compared to a positive contribution of 158 million in 2005);



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- a decrease of 1,707 million in proceeds from sale of investments in subsidiaries, net of cash disposed of ( 345 million in 2006 compared to 2,052 million in 2005).

**2005 compared to 2004**

The increase in 2005 compared to 2004 of 12,470 million was mainly due to:

- an increase of 171 million in capital expenditures on an accrual basis ( 5,173 million in 2005 compared to 5,002 million in 2004). In 2005 capital expenditures included 1,785 million for acquisitions of intangible assets ( 1,882 million in 2004) and 3,388 million for acquisitions of tangible assets ( 3,120 million in 2004);
- an increase of 389 million in acquisitions of investments in subsidiaries and businesses, net of cash acquired ( 390 million in 2005 compared to 1 million in 2004), mainly related to the purchase of the controlling interest in Liberty Surf Group and the acquisitions of Elefante TV and Delta TV;
- an increase of 13,677 million in acquisitions of other investments ( 14,544 million in 2005 compared to 867 million in 2004). Such increase was principally due to the consideration paid for the cash tender offer for TIM shares ( 13,804 million) and for further purchases of TIM shares ( 28 million) in connection with acquiring the minority interests in TIM;
- a negative effect of net change in financial receivables and other financial assets of 898 million (increase of 474 million in 2005 compared to a net decrease of 424 million in 2004).

Such negative effects were largely offset by:

- an increase of 2,009 million of proceeds from sale of investments in subsidiaries, net of cash disposed of ( 2,052 million in 2005 compared to 43 million in 2004), that were principally related to the disposals of Entel Chile, Tim Hellas, Finsiel and Tim Perù;
- an increase of 498 million of proceeds from sale/repayments of intangible, tangible and other non-current assets (a positive contribution of 950 million in 2005 compared to a positive contribution of 452 million in 2004).

*Cash flows generated by (used in) financing activities.* Cash flows used in financing activities were 7,972 million in 2006, compared to cash flows generated of 8,767 million in 2005 and compared to cash flows used of 1,714 million in 2004.

*Cash flows used in financing activities* in 2006 of 7,972 million reflected mainly the following:

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- a decrease in financial liabilities (current and non-current portion included) and other liabilities of 4,977 million, mainly as a result of repayment of non-current financial liabilities ( 9,995 million) partially offset by proceeds from non-current financial liabilities ( 5,222 million);
- the payment of dividends (distribution of reserves included) of 2,997 million.

*Cash flows generated by financing activities* in 2005 of 8,767 million reflected the following:

- an increase in financial liabilities (current and non-current portion included) and other liabilities of 11,153 million, mainly as a result of the additional debt incurred in connection with the cash tender offer for the TIM shares;
- proceeds from equity instruments of 102 million;
- a negative contribution in share capital increases/repayments of 160 million;
- the payment of dividends (distribution of reserves included) of 2,328 million.

*Cash flows used in financing activities* in 2004 of 1,714 million reflected the following:

- an increase in financial liabilities (current and non-current portion included) and other liabilities of 822 million;
- proceeds from equity instruments of 193 million;

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- a positive contribution in share capital increases/repayments of 51 million;
- the payment of dividends (distribution of reserves included) of 2,780 million.

*Cash flows generated by (used in) discontinued operations/assets held for sale.* Cash flows used in discontinued operations/assets held for sale were 13 million in 2006, compared to cash flows generated of 26 million in 2005 and compared to cash flows used of 109 million in 2004.

**5.6.2 CAPITAL RESOURCES**

***Net Financial Debt***

Net Financial Debt is a non-GAAP financial measure as defined in Item 10 of Regulation S-K under the 1934 Act. For further details please see 5.5.2 Non-GAAP Financial Measures .

On a consolidated basis, at December 31, 2006, Net Financial Debt was 37,301 million compared to 39,858 million at December 31, 2005 (a decrease of 2,557 million). Net Financial Debt at December 31, 2005, included 106 million related to the discontinued operations/assets held for sale.

Given the ratio:

Net Financial Debt

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Operating result before depreciation and amortization, capital gains

(losses) realized and impairment reversals (losses) on non-current assets

we have targeted a value of such ratio below 3.0 to be achieved within the period 2007 - 2009, also through the disposal of non-strategic equity holdings and assets.

Please see Introduction Cautionary Statement for Purposes of the Safe Harbor Provisions of the United States Private Securities Litigation Reform Act of 1995 , included elsewhere in this Annual Report, for a discussion of factors which would cause our actual results to differ materially from the target discussed above. See, also, Item 3. Key Information 3.1 Risk Factors .

*There can be no assurance that we will be able to achieve the financial target we have established.*

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Net Financial Debt is detailed in the following table:

|  | As of<br>December 31, |               |
|--|-----------------------|---------------|
|  | 2006                  | 2005          |
|  | (millions of Euro)    |               |
| <b>GROSS FINANCIAL DEBT</b>  |                       |               |
| <b>Non-current financial liabilities (Long-term debt)</b>  |                       |               |
| Financial payables   | 38,842                | 40,252        |
| Finance lease liabilities  | 1,847                 | 1,894         |
| Other financial liabilities  | 114                   |               |
|  | <b>40,803</b>         | <b>42,146</b> |
| <b>Current financial liabilities (Short-term debt), excluding financial liability relating to discontinued operations/assets held for sale</b> |                       |               |
| Financial payables   | 5,374                 | 9,572         |
| Finance lease liabilities  | 269                   | 234           |
| Other financial liabilities  | 10                    | 6             |
|  | <b>5,653</b>          | <b>9,812</b>  |
| <b>Financial liability relating to discontinued operations/assets held for sale</b>  |                       | <b>143</b>    |
| <b>TOTAL GROSS FINANCIAL DEBT (A)</b>  | <b>46,456</b>         | <b>52,101</b> |
| <b>FINANCIAL ASSETS</b>  |                       |               |
| <b>Non-current financial assets</b>  |                       |               |
| Securities other than investments  | 12                    | 8             |
| Financial receivables and other non-current financial assets   | 679                   | 988           |
|  | <b>691</b>            | <b>996</b>    |
| <b>Current financial assets, excluding financial assets relating to discontinued operations/assets held for sale</b>                           |                       |               |
| Securities   | 812                   | 378           |
| Financial receivables and other current financial assets   | 433                   | 509           |
| Cash and cash equivalents  | 7,219                 | 10,323        |
|  | <b>8,464</b>          | <b>11,210</b> |
| <b>Financial assets relating to discontinued operations/assets held for sale</b>   |                       | <b>37</b>     |
| <b>TOTAL FINANCIAL ASSETS (B)</b>  | <b>9,155</b>          | <b>12,243</b> |
| <b>NET FINANCIAL DEBT (A-B)</b>  | <b>37,301</b>         | <b>39,858</b> |



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The following chart summarizes the major components which had an impact on the change in Net Financial Debt during 2006 (in millions of Euro):

In particular:

- **capital expenditures** in 2006 total 5,114 million and decreased by 59 million from 2005. Details are as follows:

|                                      | <u>2006</u>        | <u>2005</u>  |
|--------------------------------------|--------------------|--------------|
|                                      | (millions of Euro) |              |
| Wireline                             | 3,002              | 2,823        |
| Domestic Mobile                      | 1,146              | 1,276        |
| Brazil Mobile                        | 699                | 842          |
| Media, Olivetti and other activities | 295                | 240          |
| Adjustments                          | (28)               | (8)          |
|                                      | <u>5,114</u>       | <u>5,173</u> |

About 59% of capital expenditures was used for fixed telephony activities (Wireline Business Unit) and 36% for Mobile activities (Domestic Mobile and Brazil Mobile Business Units). The remaining part was related to Olivetti, Telecom Italia Media and the Central Functions of Telecom Italia.

In addition, starting from 2006, following the introduction of new types of contracts which bind the customer to the Telecom Italia Group for periods of 12 or 24 months, or a penalty is applied, the Group capitalizes subscriber acquisition costs in intangible assets and recognizes them in the statement of income over the period of the underlying contract. Capital expenditures in 2006 include 260 million of capitalized subscriber acquisition costs. Of that amount, 14 million relates to the Wireline Business Unit, 130 million to the Mobile Domestic Business Unit and 116 million to the Brazil Mobile Business Unit.

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Additional details are provided as follows:

- with regard to fixed telephony activities, a large portion of the capital expenditures (about 36%) was used for broadband development (which mainly includes investments for ADSL) and New Services (Alice services development, IP-TV, videotelephony, etc.). About 16% of capital expenditures were for the support of the development of Broadband offerings outside Italy (in France and Germany) and the remaining expenditures were for the development of network and support systems (Business Support Systems such as billing, revenue assurance, customer care and Operational Support Systems).

Capital expenditures for fixed telephony refer to the following:

|                                | 2006               |               | 2005               |               |
|--------------------------------|--------------------|---------------|--------------------|---------------|
|                                | (millions of Euro) | % of total    | (millions of Euro) | % of total    |
| Broadband development in Italy | 622                | 20.7%         | 678                | 24.0%         |
| New services development       | 463                | 15.4%         | 528                | 18.7%         |
| European projects (Broadband)  | 467                | 15.6%         | 304                | 10.8%         |
| Other                          | 1,450              | 48.3%         | 1,313              | 46.5%         |
| <b>Total</b>                   | <b>3,002</b>       | <b>100.0%</b> | <b>2,823</b>       | <b>100.0%</b> |

- with regard to domestic mobile telephony, 50% of capital expenditures were used for the development of the UMTS and Systems Development (in particular, software development for the launch of new plans and services). The remainder of the capital expenditures related to revamping the network, supporting sales policies and costs for the acquisition of subscribers.

Capital expenditures for domestic mobile telephony refer to the following:

|                     | 2006               |               | 2005               |               |
|---------------------|--------------------|---------------|--------------------|---------------|
|                     | (millions of Euro) | % of total    | (millions of Euro) | % of total    |
| UMTS                | 265                | 23.1%         | 282                | 22.1%         |
| Systems development | 308                | 26.9%         | 278                | 21.8%         |
| Other               | 573                | 50.0%         | 716                | 56.1%         |
| <b>Total</b>        | <b>1,146</b>       | <b>100.0%</b> | <b>1,276</b>       | <b>100.0%</b> |

- with regard to mobile telephony in Brazil, the reduction in capital expenditures by the Business Unit is connected with the gradual completion of mobile coverage of the territory;



- the **sale of investments and other disposals** led to a reduction in debt of 1,375 million and refers to the following transactions:
  - sale of the investment in Gruppo Buffetti for 66 million (including the deconsolidation of the net financial debt of the subsidiary sold);
  - disposal of the real estate investment in Ruf Gestion for 51 million (including the deconsolidation of the net financial debt of the subsidiary sold);
  - sale of Corporación Digitel C.A. (Digitel Venezuela) for 318 million (including the deconsolidation of the net financial debt of the subsidiary sold);
  - sale of Neuf Télécom for 199 million;
  - sale of Avea I.H.A.S. to Turk Telekom for 279 million; this amount is the net balance between the proceeds on the sale ( 393 million) and the recognition of non-current financial liabilities for 114 million, corresponding to the gain temporarily deferred on the sale of Avea I.H.A.S., against the commitments undertaken for a subordinated loan to grant to Avea I.H.A.S. for an amount of U.S.\$150 million; the total net impact of the transaction for the sale of Avea I.H.A.S. amounts to 82 million since, at the time of the sale of the investment, the Telecom Italia Group invested 197 million in Oger Telecom (the parent of Turk Telekom);
  - disposals of real estate property by the Group to the closed-end real estate investment funds Raissa and Spazio Industriale which reduced debt by 296 million. Such disposals are part of the property sales program approved by the Board of Directors meeting on December 21, 2005 and completed in 2006;

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- reimbursements of capital and the distribution of dividends by Tiglio I, Tiglio II and Telegono ( 43 million);
- collection of the remaining receivable on the sale, in 2005, of the Finsiel group ( 27 million);
- sale of other non-current assets, reimbursements of capital and distribution of dividends by associates ( 96 million);
- the **collection of the receivable for the telecommunications operating fee and the payment of the Antitrust Authority fine** reduced debt by a net amount of 431 million; of that amount, 115 million refers to the payment of the fine levied by the Antitrust Authority for the alleged abuse of a dominant position and 546 million refers to the refund from the Italian government following the ruling handed down by the Regional Administrative Court of Lazio on July 10, 2006, for the principal portion of the telecommunications operating fee that Telecom Italia and TIM had paid for the year 1999 pursuant to art. 20, Law 448 dated December 23, 1998.

Securitization and factoring arrangements led to an improvement in consolidated Net Financial Debt as of December 31, 2006 of 1,499 million, as follows:

|                | <b>As of December 31,</b> |              |
|----------------|---------------------------|--------------|
|                | <b>2006</b>               | <b>2005</b>  |
|                | <b>(millions of Euro)</b> |              |
| Securitization |                           | 648          |
| Factoring      | 1,499                     | 615          |
| <b>Total</b>   | <b>1,499</b>              | <b>1,263</b> |

The Group's original securitization program came to its natural end in the month of July 2006. In the second half of the year 2006, contracts were signed with leading financial counterparties for the sale of both the same type of receivables in the securitization transactions and other contracts for the sale of receivables.

**Gross Financial Debt**

On a consolidated basis, at December 31, 2006 our gross financial debt amounted to 46,456 million ( 52,101 million at December 31, 2005) and included non-current financial liabilities (long-term debt) of 40,803 million ( 42,146 million at December 31, 2005), current financial liabilities (short-term debt) of 5,653 million ( 9,812 million at December 31, 2005).

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As of December 31, 2006 approximately 71% of our gross financial debt was denominated in Euro, while the remainder was primarily denominated in U.S. Dollars, Pound Sterling, Brazilian Reais and Japanese Yen.

The following table sets out the currency composition of our gross financial debt:

|  | As of December 31,                     |            |                        |            |               |            |               |            |
|--|--|------------|------------------------|------------|---------------|------------|---------------|------------|
|  | 2006                                   |            |                        |            | 2005          |            |               |            |
|  | Euro                                   | %          | Foreign<br>currency(*) | %          | Total         | %          | Total         | %          |
|  | (millions of euro, except percentages) |            |                        |            |               |            |               |            |
| Long-term debt   | 27,760                                 | 84         | 13,043                 | 96         | 40,803        | 88         | 42,146        | 81         |
| Short-term debt (including<br>current portion of long term debt) | 5,172                                  | 16         | 481                    | 4          | 5,653         | 12         | 9,812         | 19         |
| <b>Total gross financial debt</b>                                | <b>32,932</b>                          | <b>100</b> | <b>13,524</b>          | <b>100</b> | <b>46,456</b> | <b>100</b> | <b>51,958</b> | <b>100</b> |
| <b>Discontinued operations/assets held for sale</b>              |  |            |                        |            |               |            | 143           |            |
| <b>Total</b>   |  |            |                        |            | <b>46,456</b> |            | <b>52,101</b> |            |

(\*) Before hedging transactions.

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In 2006, the share of our long-term debt (excluding current portion) as a percentage of total gross financial debt increased from 81% to 88%. At December 31, 2006 approximately 30% of the long-term debt (including current portion) carried a floating rate compared to 34% at December 31, 2005.

Long-term debt includes notes we have issued in order to reduce our dependence on short-term debt, extend the average life of our financial debt and expand our investor base. For this purpose, we issue long-term debt in the capital markets under, among others:

- the Telecom Italia Euro Medium Term Note ( **EMTN** ) Programme. On December 21, 2005, the Board of Directors of Telecom Italia S.p.A. set a new maximum ceiling for its EMTN Programme, which regulates the placement, also for more than one transaction, for more than one tranche and for more than one currency, of bonds by Telecom Italia S.p.A. and/or its wholly-owned subsidiary Telecom Italia Finance S.A. under a guarantee by Telecom Italia S.p.A. The new maximum ceiling was raised to 15 billion against the previous 10 billion (of which slightly less than 8 billion had already been used at December 31, 2005). At the same time, the Board of Directors authorized the issue of non-convertible bonds in 2006 up to a maximum of 4.5 billion;
- the Form F-3 registration statement, filed with the Securities and Exchange Commission on August 9, 2005 and effective as of August 30, 2005 which allows issuances for a total amount of U.S.\$10 billion in debt at various terms, rates and maturities;
- the Olivetti Euro Medium Term Note Programme, as updated and amended on June 8, 2001 and May 14, 2002, which allows for the issuance of a total amount of 15 billion in debt (or the equivalent in other currencies), at various terms, rates and maturities;
- the Old Telecom Italia Global Medium Term Note Program ( **Global Note Program** ), which allows for the issuance of a total amount of U.S.\$12 billion in debt (or the equivalent in other currencies), at various terms, rates and maturities.

The following table highlights the utilization of the EMTN Programme at the end of 2006 compared to the prior year.

**Telecom Italia Group EMTN Programme: utilization status**

|  | As of December 31, |                  |
|--|--------------------|------------------|
|  | 2006               | 2005             |
|  | (millions of Euro) |                  |
| <b>Total amount of EMTN Programme</b>  | <b>15,000.00</b>   | <b>10,000.00</b> |
| <b>Notes and bonds issued:(1)</b>      | <b>10,435.40</b>   | <b>7,839.70</b>  |
| <i>of which: Telecom Italia S.p.A.</i> | <i>9,186.00</i>    | <i>7,090.00</i>  |

|  |                   |                 |
|--|-------------------|-----------------|
| <i>Telecom Italia Finance S.A.</i>       | <i>1,249.40</i>   | <i>749.70</i>   |
| <b>Notes and bonds repaid:(1)</b>        | <b>(1,000.05)</b> |                 |
| <i>of which: Telecom Italia S.p.A.</i>   | <i>(1,000.00)</i> |                 |
| <i>Telecom Italia Finance S.A.</i>       | <i>(0.05)</i>     |                 |
|  | <hr/>             | <hr/>           |
| <b>Net utilization of EMTN Programme</b> | <b>9,435.35</b>   | <b>7,839.70</b> |
|  | <hr/>             | <hr/>           |
| <b>Remaining available amount(2)</b>     | <b>5,564.65</b>   | <b>2,160.30</b> |
|  | <hr/>             | <hr/>           |

(1) Cumulative amount since the start of the EMTN Programme.

(2) Two further issuances of debt for a total principal amount of 1,250 million were made in June 2007. For further details please see Note 48 Additional U.S. GAAP Disclosures Subsequent Events of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report.

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With reference to the gross financial debt the following should be noted:

- with regard to notes and bonds (including convertible notes and bonds), the following transactions took place during the year ended December 31, 2006:
  - **New issues:**
    - Telecom Italia S.p.A. launched three new bond issues under the 15 billion EMTN Programme: (a) on May 19, 2006, a dual-tranche issue for 750 million and GBP 400 million, respectively, and (b) on June 9, 2006 for 750 million;
    - on July 18, 2006, Telecom Italia Capital S.A. issued multi-tranche bonds on the American market for a total of U.S.\$2,600 million. The issue was in three tranches for U.S.\$850 million, U.S.\$750 million and U.S.\$1,000 million, respectively;
    - on September 14, 2006, Telecom Italia Finance S.A. extended the maturity date of the Euro 499,717,000 Guaranteed Floating Rate Extendable Notes due 2006 to September 14, 2008. At December 31, 2006, the residual nominal debt is equal to 499,669,000; and
    - the Telecom Italia S.p.A. 2002-2022 bond, set aside for subscription by employees of the Group, at December 31, 2006 was equal to 250 million (nominal amount) and increased during 2006 by 2 million ( 248 million at December 31, 2005).
  - **Repurchases of bonds:**
    - Telecom Italia Finance S.A. repurchased bonds equal to a total nominal amount of 128.4 million during 2006.
  - **Repayments and conversions:**
    - repayment of Telecom Italia Finance S.A. 1,100,000,000 Floating Rates Notes due 2006 ;
    - early repayment of Telecom Italia S.p.A. 1,000,000,000 Floating Rates Notes due 2007 ;
    - repayment of Telecom Italia Finance S.A. 1% Exchangeable Notes due 2006 ;
    - repayment of Telecom Italia Finance S.A. 6.125% Notes due 2006 ;

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- early repayment of Telecom Italia Finance S.A. 5.625% Bonds due 2046 ;
- conversion of Telecom Italia S.p.A. 1.5% 2001-2010 convertible notes with a repayment premium ;
- partial repayment of Telecom Italia Finance S.A. Extendable Floating Rate Notes due 2006 .

Our debt due to banks was 7,738 million at December 31, 2006 ( 10,108 million at December 31, 2005), of which 906 million ( 646 million at December 31, 2005) was short-term debt, including the current portion of long-term debt.

### **Notes and bonds (including convertible and exchangeable notes/bonds)**

As of December 31, 2006, the non-current and current portions of notes and bonds (including convertible and exchangeable notes/bonds) amounted to 34,395 million ( 37,981 million at December 31, 2005, including convertible and exchangeable notes/bonds) and consisted of the following:

|  | As of December 31, 2006 |                    |               | As of December 31, 2005 |                    |               |
|--|-------------------------|--------------------|---------------|-------------------------|--------------------|---------------|
|  | Non-current<br>portion  | Current<br>portion | Total         | Non-current<br>portion  | Current<br>portion | Total         |
|  | (millions of Euro)      |                    |               |                         |                    |               |
| Notes and bonds                          | 29,856                  | 4,050              | 33,906        | 29,281                  | 6,181              | 35,462        |
| Convertible and exchangeable notes/bonds | 482                     | 7                  | 489           | 476                     | 2,043              | 2,519         |
| <b>Total</b>                             | <b>30,338</b>           | <b>4,057</b>       | <b>34,395</b> | <b>29,757</b>           | <b>8,224</b>       | <b>37,981</b> |

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At December 31, 2006, the nominal repayment amount for notes and bonds (including convertible notes/bonds) amounted to 33,693 million ( 37,219 million at December 31, 2005 including convertible and exchangeable notes) and consisted of the following:

|                                    | <b>As of December 31,<br/>2006</b> | <b>As of December 31,<br/>2005</b> |
|------------------------------------|------------------------------------|------------------------------------|
|                                    | (millions of Euro)                 |                                    |
| Notes and bonds                    | 33,119                             | 34,577                             |
| Convertible and exchangeable notes | 574                                | 2,642                              |
| <b>Total</b>                       | <b>33,693</b>                      | <b>37,219</b>                      |

At December 31, 2006, outstanding convertible notes consisted of the following:

| <b>Original Currency</b>                                 | <b>Nominal<br/>repayment<br/>amount<br/>(millions<br/>of Euro)</b> | <b>Coupon</b> | <b>New shares issuer</b> | <b>Issue date</b> | <b>Maturity<br/>date</b> | <b>Issue<br/>price<br/>(%)</b> | <b>Market price<br/>as of<br/>December 31,<br/>2006 (%)</b> | <b>Market value<br/>as of<br/>December 31,<br/>2006<br/>(millions of<br/>Euro)</b> |
|--|--|---------------|--------------------------|-------------------|--------------------------|--------------------------------|---|--|
| <b>Convertible notes issued by Telecom Italia S.p.A.</b> |  |               |                          |                   |                          |                                |   |  |
| Euro   | 574  | 1.5%          | Telecom Italia S.p.A.    | 11/23/2001        | 01/01/2010               | 100                            | 120.948   | 587  |



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At December 31, 2006 notes and bonds were detailed as follows:

| Original<br>Currency   | Amount<br>in original<br>currency<br>(million) | Nominal<br>repayment<br>amount<br>in Euro<br>(million) | Coupon                     | Issue date | Maturity<br>date | Issue price<br>(%) | Market<br>price as of<br>December 31,<br>2006 (%) | Market<br>value as of<br>December 31,<br>2006<br>(millions<br>of Euro) |
|--|--|--|----------------------------|------------|------------------|--------------------|---|--|
| <b>Notes and bonds issued by Telecom Italia S.p.A.</b>   |  |  |                            |            |                  |                    |   |  |
| Euro   | 1,250  | 1,250  |                            | 02/01/2002 | 02/01/2007       | 99.841             | 100.126   | 1,252  |
| Euro   | 750  | 750  | 3 month Euribor +0.22%     | 06/09/2006 | 06/09/2008       | 100                | 100.000   | 750  |
| Euro   | 110  | 110  | 3 month Euribor +0.60%     | 04/08/2004 | 03/30/2009       | 100                | 100.797   | 111  |
| Euro   | 750  | 750  |                            | 01/29/2004 | 01/28/2011       | 99.56              | 99.390  | 745  |
| Euro   | 1,250  | 1,250  |                            | 02/01/2002 | 02/01/2012       | 98.952             | 106.038   | 1,325  |
| Euro   | 1,000  | 1,000  | 3 month Euribor +0.53%     | 12/06/2005 | 12/06/2012       | 100                | 99.270  | 993  |
| Euro   | 750  | 750  |                            | 05/19/2006 | 05/19/2014       | 99.156             | 98.000  | 735  |
| Euro   | 120  | 120  | 3 month Euribor +0.66%     | 11/23/2004 | 11/23/2015       | 100                | 97.694  | 117  |
| GBP  | 500  | 744  |                            | 06/29/2005 | 12/29/2015       | 99.878             | 95.120  | 708  |
| Euro   | 1,250  | 1,250  |                            | 01/29/2004 | 01/29/2019       | 99.07              | 98.430  | 1,230  |
| GBP  | 850  | 1,266  |                            | 06/24/2004 | 06/24/2019       | 98.85              | 100.076   | 1,267  |
| Euro   | 250  | 250  | 6 month Euribor (Base 365) | 01/01/2002 | 01/01/2022       | 100                | 100.000   | 250  |
| GBP  | 400  | 596  |                            | 05/19/2006 | 05/19/2023       | 99.622             | 95.714  | 570  |
| Euro   | 850  | 850  |                            | 03/17/2005 | 03/17/2055       | 99.667             | 84.550  | 719  |
| <b>Sub-Total</b>   |  | <b>10,936</b>  |                            |            |                  |                    |   | <b>10,772</b>  |
| <b>Notes and bonds issued by Telecom Italia Finance S.A. and guaranteed by Telecom Italia S.p.A.</b> |  |  |                            |            |                  |                    |   |  |
| Euro   | 1,720  | 1,720  |                            | 04/24/2002 | 04/24/2007       | 100.911(*)         | 100.697   | 1,732  |
| Euro   | 1,659  | 1,659  |                            | 01/24/2003 | 01/24/2008       | 99.937             | 101.607   | 1,686  |
| Euro   | 499.67   | 500  | 3 month Euribor +1.3%      | 09/14/2006 | 09/14/2008       | 100                | 103.259   | 516  |
| Euro   | 1,500  | 1,500  |                            | 02/09/1999 | 02/09/2009       | 99.633             | 101.501   | 1,523  |
| Euro   | 2,210  | 2,210  |                            | 07/30/1999 | 07/30/2009       | 98.649(*)          | 105.114   | 2,323  |
| Euro   | 2,000  | 2,000  |                            | 04/20/2001 | 04/20/2011       | 99.214             | 110.221   | 2,204  |
| Euro   | 1,000  | 1,000  |                            | 04/24/2002 | 04/24/2012       | 101.651(*)         | 110.782   | 1,108  |
| Euro   | 850  | 850  |                            | 01/24/2003 | 01/24/2013       | 99.332             | 109.599   | 932  |
| JPY  | 20,000   | 127  |                            | 04/22/2002 | 05/14/2032       | 99.25              | 122.728   | 156  |
| Euro   | 1,050  | 1,050  |                            | 01/24/2003 | 01/24/2033       | 109.646(*)         | 118.860   | 1,248  |
| <b>Sub-Total</b>   |  | <b>12,616</b>  |                            |            |                  |                    |   | <b>13,428</b>  |
| <b>Notes and bonds issued by Telecom Italia Capital S.A. and guaranteed by Telecom Italia S.p.A.</b> |  |  |                            |            |                  |                    |   |  |
| USD  | 1,000  | 759  |                            | 10/29/2003 | 11/15/2008       | 99.953             | 97.326  | 739  |
| USD  | 1,250  | 949  |                            | 10/06/2004 | 01/15/2010       | 99.732             | 95.498  | 906  |
| USD  | 700  | 532  |                            | 09/28/2005 | 10/01/2010       | 99.898             | 97.202  | 517  |
| USD  | 400  | 304  | 3 month US Libor +0.48%    | 09/28/2005 | 02/01/2011       | 100                | 99.476  | 302  |
| USD  | 850  | 645  | 3 month US Libor +0.61%    | 07/18/2006 | 07/18/2011       | 100                | 99.867  | 644  |
| USD  | 750  | 570  |                            | 07/18/2006 | 07/18/2011       | 99.826             | 101.448   | 578  |
| USD  | 2,000  | 1,519  |                            | 10/29/2003 | 11/15/2013       | 99.742             | 95.418  | 1,449  |
| USD  | 1,250  | 949  |                            | 10/06/2004 | 09/30/2014       | 99.651             | 92.600  | 879  |
| USD  | 1,400  | 1,063  |                            | 09/28/2005 | 10/01/2015       | 99.370             | 93.173  | 990  |

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|                  |       |               |        |            |            |        |         |               |
|------------------|-------|---------------|--------|------------|------------|--------|---------|---------------|
| USD              | 1,000 | 759           | 6.375% | 10/29/2003 | 11/15/2033 | 99.558 | 94.430  | 717           |
| USD              | 1,000 | 759           | 6.000% | 10/06/2004 | 09/30/2034 | 99.081 | 90.759  | 689           |
| USD              | 1,000 | 759           | 7.200% | 07/18/2006 | 07/18/2036 | 99.440 | 104,022 | 790           |
| <b>Sub Total</b> |       | <b>9,567</b>  |        |            |            |        |         | <b>9,200</b>  |
| <b>Total</b>     |       | <b>33,119</b> |        |            |            |        |         | <b>33,400</b> |

Notes (a), (b), (c): see the following paragraph Mechanism describing how coupons change on step-up/step-down notes and bonds in relation to a change in the rating .

(\*) Weighted average issue price for notes and bonds issued with more than one tranche.

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**Rating Triggers**

As of the date hereof Telecom Italia had the following ratings:

|                    | As of December 31, 2006 |             |
|--------------------|-------------------------|-------------|
|                    | Rating                  | Outlook     |
| Standard & Poor's: | BBB+                    | Negative(1) |
| Moody's:           | Baa2                    | Negative(2) |
| Fitch Ratings:     | BBB+                    | Stable(3)   |

(1) On March 13, 2007, Standard & Poor's confirmed its BBB+ *negative outlook* rating.

(2) On March 12, 2007, Moody's revised its expectations on Telecom Italia, changing its outlook from Stable to Negative, and affirmed the Baa2 rating on the company.

(3) On March 15, 2007, Fitch Ratings confirmed its BBB+ *stable outlook* rating.

**a) Telecom Italia Finance S.A. Euro Notes : 2,000 million, 7% interest, maturing April 2011**

These securities carry protection for investors which would be triggered by a change in the rating assigned to Telecom Italia to below the Baa1/BBB+ ratings (by Moody's and S&P's, respectively): each downgrade in the rating by one notch by each of the two rating agencies to below the stated thresholds would cause an increase in the coupon rate of 0.25%, starting from the coupon payment date subsequent to the downgrade in the rating.

The downgrade in the rating from the thresholds is evaluated at the end of each coupon period and, on the basis of this evaluation, the interest for the next coupon is fixed; therefore, changes in the ratings during the coupon interest period would have no impact on the coupon payable during that period.

Nevertheless, the relative step-up/step-down will only be applied when the rating at the end of the coupon period is different from the rating at the end of the preceding coupon period.

By virtue of this mechanism, the coupons for these securities are currently subject to an increase of 0.25% due to a Baa2 rating assigned by Moody's in August 2003. The increase was applied beginning from the coupon period which started in April 2004,

accordingly, the coupon is equal to 7.25% for securities maturing in April 2011.

**b) Telecom Italia Finance S.A. notes: 1,500 million, 5.15% interest, maturing February 2009**

These notes carry protection for investors which would only be triggered by a downgrade in the minimum rating (among the ratings assigned by the various agencies, in this specific case, the Baa2 rating by Moody's).

At the beginning of every coupon period, this minimum rating will be checked, and depending upon the rating, the coupon interest will be fixed; once fixed, changes in the minimum rating during the coupon period will have no effect on the coupon to be paid, and will only have an impact when the next coupon interest rate is fixed (if the changes are still in effect).

Starting from the initial level of the coupon at issue (5%), a 0.15% increase in interest was granted to investors to remain in place until to the maturity date, bringing the current coupon interest rate to 5.15%.

This current coupon can be further increased in relation to the level of the minimum rating:

- if, at the time the coupon interest is fixed, the minimum rating is Ba1/BB+ or below, the current coupon will be increased by 1.5%;
- if, at the time the coupon interest is fixed, the minimum rating is Baa3/BBB-, the current coupon will be increased by 0.5%;
- ratings higher than the minimum rating do not lead to increases in the current coupon.

Therefore, only future downgrades in the minimum rating could cause an increase in the current coupon; this coupon cannot be reduced because of upgrades in the rating.

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**c) Telecom Italia Finance S.A. notes: 2,210 million, 6.575% interest, maturing July 2009**

These notes carry protection for investors which would be triggered by a change in the minimum rating (among those assigned by the various agencies, in this specific case, the Baa2 rating by Moody's).

At the beginning of every coupon period, this minimum rating will be checked and depending upon the rating, the coupon interest will be fixed; once fixed, changes in the minimum rating during the coupon period will have no effect on the coupon to be paid, and will only have an impact when the next coupon interest rate is fixed (if the changes are still in effect).

Starting from the initial level of interest at issue (6.125%), the coupon to be paid will be increased in relation to the level of the minimum rating:

- if, at the time the coupon is fixed, the minimum rating is Ba1/BB+ or below, the original coupon will be increased by 1.95%;
- if, at the time the coupon interest is fixed, the minimum rating is Baa3/BBB-, the original coupon will be increased by 0.95%;
- if, at the time the coupon interest is fixed, the minimum rating is Baa2/BBB, the original coupon will be increased by 0.45%;
- if, at the time the coupon interest is fixed, the minimum rating is Baa1/BBB+, the original coupon will be increased by 0.15%;
- ratings higher than the minimum rating do not lead to increases in the original coupon.

Under this mechanism, since October 2000 (the date the mechanism was introduced), the original coupon has been increased by 0.45% (reaching the current 6.575%).

Future upgrades/downgrades in the minimum rating could cause a reduction/increase in the coupon according to the mechanism described above.

**Financial covenants / other covenants / other features of convertible notes and bonds**

Bonds issued by companies of the Group to third parties do not contain either financial covenants or terms and conditions that would require the early repayment of the bonds in relation to events other than the insolvency of the Telecom Italia Group. Furthermore, the repayment of the bonds and the payment of interest are not covered by specific guarantees nor there are commitments provided relative to the assumption of future guarantees, except for the full and unconditional guarantees provided by Telecom Italia S.p.A. for the bonds issued by Telecom Italia Finance S.A. and Telecom Italia Capital S.A..

None of the securities summarized here carry any other interest rate structures or structural complexities.

Since these bonds have been placed principally with institutional investors on major world capital markets (Euromarket and the U.S.A.), the terms which regulate the bonds are in line with market practice for similar transactions effected on these same markets.

For a tabular description of our debt please see Note 18 Financial liabilities (current and non-current) of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report.

#### ***Bank Facilities***

Committed credit lines outstanding at the end of 2006, consisting of the Revolving Credit Facilities, amount to 8 billion, divided as follows:

- 2 billion credit line expiring in March 2007, completely undrawn;
- 6 billion credit line expiring in August 2012 drawn down for 1.5 billion.

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This composition and the level of the credit lines were achieved through the repayment of the credit line expiring in 2012 and the partial cancellation of the credit line expiring in 2007, during the course of 2006. A summary follows:

|   | Revolving Credit Facilities<br>expiring 2007 |            | Revolving Credit Facilities<br>expiring 2012 |            | Total   |            |
|---|--|------------|--|------------|---------|------------|
|   | Granted                                      | Drawn down | Granted                                      | Drawn down | Granted | Drawn down |
| (billions of Euro)                                    |  |            |  |            |         |            |
| As of December 31, 2005                               | 5.0  |            | 6.0  | 4.5        | 11.0    | 4.5        |
| Situation at June 13, 2006 following<br>repayment     | 3.5  |            | 6.0  | 3.0        | 9.5     | 3.0        |
| Situation at December 20, 2006<br>following repayment | 2.0  |            | 6.0  | 1.5        | 8.0     | 1.5        |
| As of December 31, 2006                               | 2.0  |            | 6.0  | 1.5        | 8.0     | 1.5        |

On January 15, 2007, 2 billion of the remaining available syndicated credit line expiring in March 2007 was cancelled and at the same time the Revolving Credit Facility expiring in 2012 was increased by the same amount. The new Revolving Credit Facility is therefore equal to 8 billion and, as of June 13, 2007, the total undrawn and available committed credit lines of Telecom Italia Group were equal to 6.6 billion.

Telecom Italia's syndicated bank lines do not contain financial covenants that, if not complied with, would require the repayment of the existing loan. They do provide for the normal negative pledge clauses (within the limits of requirements for operations). These credit lines are subject, only with regard to the interest margin, to variations in the ratings which would pertain to the credit risk of the company, on the basis of a pre-set grid.

**Debt to Equity Ratio.** The Telecom Italia Group's debt to equity ratio, calculated as the ratio of consolidated net financial debt to equity (including Minority Interests), was 137.7% and 147.7% as of December 31, 2006 and December 31, 2005, respectively.

**Centralized Treasury.** Telecom Italia has a centralized treasury that provides financial assistance to the Telecom Italia Group, and generally operates as the Group's principal banker, allocating cash where needed and collecting the liquid resources of the members of the Group. As a result, we are able to ensure that our subsidiaries have adequate liquidity to satisfy their requirements. Telecom Italia also acts on behalf of its subsidiaries in negotiating bank lines of credit and provides financial consultancy services to its subsidiaries.

The central treasury function reduces the need for the members of the Group to utilize banks, enables members of the Group to obtain more favorable terms from banks when needed and enables us to maintain control over cash flows and to assure better

utilization of surplus liquidity.

**Cash Management.** We utilize short-term credit lines to support expenses and disbursements that occur in the ordinary course of business, using free cash flow generated by its business to fund capital expenditures and acquisitions and to repay long-term debt.

**Lines of Credit.** Short-term lines of credit granted to the Telecom Italia Group by banks, according to standard money market terms and conditions, consist partly of lines of credit with specified maturities and partly of lines of credit callable upon notice. All of the Company's medium and long-term lines of credit relate to specific loans drawn down to fund the Company's activities.

#### ***Off-Balance Sheet Arrangements***

Off-balance sheet arrangements refer to any transaction, agreement, or other contractual arrangement (other than contingent liabilities arising from litigation, arbitration or regulatory actions), involving an unconsolidated entity under which Telecom Italia has:

- guarantee contracts required to be initially recorded at fair value under FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others (FIN 45);



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- retained or contingent interests in transferred assets;
- any obligation under derivative instruments classified as equity; or
- any obligation arising out of a material variable interest in an unconsolidated entity that provides financing, liquidity, market risk or credit risk support to the company, or that engages in leasing, hedging, or research and development arrangements with the company.

As of December 31, 2006, the Telecom Italia Group had the following items that are considered to be off-balance sheet.

*Purchase commitments* for 455 million related mainly to:

- 164 million of property lease rentals under contracts lasting more than 6 years;
- 242 million of orders to suppliers of Telenergia relating to the electrical power supply agreements reached with Endesa;
- 17 million for the purchase by Telecom Italia Media Broadcasting of radio and television equipment in Sicily.

*Sale commitments* for a total amount of 2 million.

The purchase and sale commitments above refer to commitments that do not fall within the normal operating cycle of the Group.

As of December 31, 2006, the Group has given guarantees of 330 million, net of 180 million of counter-guarantees received, and consisted mainly of sureties provided by Telecom Italia on behalf of associated companies ( 102 million) and others for medium and long-term loans.

In addition, the 47.80% interest in Tiglio I and the 49.47% interest in Tiglio II have been pledged to the banks that financed the two associates.

As of December 31, 2006 Telecom Italia Group companies have also issued support letters for a total of 141 million, mainly on behalf of associates to guarantee insurance policies, lines of credit and overdraft arrangements.

For further details please see Note 26 Contingent assets and liabilities, commitments and other guarantees of the Notes to the Consolidated Financial Statements.

***Contractual Obligations and Commitments***

The following tables aggregate our contractual obligations and commitments with definitive payment terms which will require significant cash outlays in the future in terms of nominal amounts and carrying values in accordance with IFRS.

In 2007 we repaid on February 1, 2007 the Telecom Italia S.p.A. Euro 1,250,000,000 Notes 5.625% due 2007 at maturity.

The average maturity of financial non-current liabilities was equal to 7.99 years.

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As of December 31, 2006, the nominal repayment amounts of payables and the relating expiration dates were as follows:

|   | Amounts due as of December 31, |              |              |              |              |               | Total         |
|---|--------------------------------|--------------|--------------|--------------|--------------|---------------|---------------|
|   | 2007                           | 2008         | 2009         | 2010         | 2011         | After 2011    |               |
|   | (millions of Euro)             |              |              |              |              |               |               |
| Notes and bonds                         | 2,970                          | 3,668        | 3,820        | 2,055        | 4,268        | 16,912        | 33,693        |
| Loans and other debts                   | 623                            | 603          | 265          | 3,265        | 222          | 3,599         | 8,577         |
| <b>Sub-total</b>                        | <b>3,593</b>                   | <b>4,271</b> | <b>4,085</b> | <b>5,320</b> | <b>4,490</b> | <b>20,511</b> | <b>42,270</b> |
| Finance leases                          | 149                            | 97           | 64           | 43           | 20           | 4             | 377           |
| Long rent                               | 101                            | 90           | 90           | 99           | 98           | 1,242         | 1,720         |
| <b>Total non-current financial debt</b> | <b>3,843</b>                   | <b>4,458</b> | <b>4,239</b> | <b>5,462</b> | <b>4,608</b> | <b>21,757</b> | <b>44,367</b> |
| <b>Current financial liabilities</b>    | <b>472</b>                     |              |              |              |              |               | <b>472</b>    |
| <b>Total</b>                            | <b>4,315</b>                   | <b>4,458</b> | <b>4,239</b> | <b>5,462</b> | <b>4,608</b> | <b>21,757</b> | <b>44,839</b> |

As of December 31, 2006 the carrying amounts of payables due under IFRS (including fair value adjustment and measurement at amortized cost) and the relating expiration dates were as follows:

|   | Amounts due as of December 31, |              |              |              |              |               | Total         |
|---|--------------------------------|--------------|--------------|--------------|--------------|---------------|---------------|
|   | 2007                           | 2008         | 2009         | 2010         | 2011         | After 2011    |               |
|   | (millions of Euro)             |              |              |              |              |               |               |
| Notes and bonds                         | 4,057                          | 3,646        | 3,862        | 1,907        | 4,277        | 16,646        | 34,395        |
| Loans and other debts                   | 914                            | 633          | 264          | 3,303        | 223          | 4,195         | 9,532         |
| <b>Sub-total</b>                        | <b>4,971</b>                   | <b>4,279</b> | <b>4,126</b> | <b>5,210</b> | <b>4,500</b> | <b>20,841</b> | <b>43,927</b> |
| Finance leases                          | 149                            | 97           | 64           | 43           | 20           | 4             | 377           |
| Long rent                               | 120                            | 90           | 90           | 99           | 98           | 1,242         | 1,739         |
| <b>Total non-current financial debt</b> | <b>5,240</b>                   | <b>4,466</b> | <b>4,280</b> | <b>5,352</b> | <b>4,618</b> | <b>22,087</b> | <b>46,043</b> |
| <b>Current financial liabilities</b>    | <b>413</b>                     |              |              |              |              |               | <b>413</b>    |
| <b>Total</b>                            | <b>5,653</b>                   | <b>4,466</b> | <b>4,280</b> | <b>5,352</b> | <b>4,618</b> | <b>22,087</b> | <b>46,456</b> |

As of December 31, 2006 the above short-term financial commitments were covered by current financial assets amounting to 8,464 million ( 8,277 million at nominal amounts), which cover also the commitments maturing in 2008, without taking into account the new committed credit lines described above which have undrawn amounts of 6.6 billion.

For further details please see also Note 24 Financial instruments in the Notes to Consolidated Financial Statements included elsewhere in this Annual Report.

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The table below sets forth, for the periods indicated, our total capital expenditures on an accrual basis based on the organization by Business Unit at December 31, 2006.

|  | Year ended December 31, |              |              |
|--|-------------------------|--------------|--------------|
|  | 2006(1)                 | 2005(1)(2)   | 2004(1)(2)   |
|  | (millions of Euro)      |              |              |
| Acquisitions of tangible assets:               |                         |              |              |
| Wireline                                       | 1,881                   | 1,972        | 1,432        |
| Domestic Mobile                                | 538                     | 671          | 821          |
| Brazil Mobile                                  | 342                     | 598          | 701          |
| Media  | 29                      | 27           | 16           |
| Olivetti                                       | 10                      | 18           | 14           |
| Other activities(3)                            | 127                     | 102          | 136          |
| <b>Total acquisition of tangible assets(4)</b> | <b>2,927</b>            | <b>3,388</b> | <b>3,120</b> |
| Acquisition of intangible assets(5)            | 2,187                   | 1,785        | 1,882        |
| <b>Total capital expenditures(6)</b>           | <b>5,114</b>            | <b>5,173</b> | <b>5,002</b> |

(1) All financial data exclude those relating to the consolidated companies considered as discontinued operations / assets held for sale.

(2) The data relating to 2004 and 2005 have been reclassified and presented consistent with the 2006 presentation.

(3) The economic and financial results of Entel Bolivia have been included in Other activities.

(4) Acquisitions of tangible assets are mainly related to local and long distance networks, exchange equipment, investments in subscribers equipment, radio and transmission equipment.

(5) Acquisitions of intangible assets include expenditures such as software for telecommunications systems and licenses.

(6) Intercompany capital expenditures are adjusted to eliminate intercompany profit.

In the three years ended December 31, 2006, 2005 and 2004, cash flows generated by operating activities ( 9,194 million in 2006, 9,778 million in 2005 and 10,266 in 2004) exceeded capital expenditures on an accrual basis ( 5,114 million in 2006, 5,173 million in 2005 and 5,002 million in 2004).

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The capital expenditures planned for the three years 2007-2009 will be approximately 15 billion. The breakdown by sector of activity is as follows:

- Domestic Business for approximately 11.0 billion;
- European Broadband Project for approximately 1.2 billion; and
- Tim Brasil for approximately 2.4 billion.

For further details please see 5.6.2 Capital Resources .

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

**Research, Development And Innovation**

**5.7 RESEARCH, DEVELOPMENT AND INNOVATION**

The Italian market for telecommunications is considered among the most advanced, both from a technological viewpoint and evolution of customer attitudes as well as customer consumption profiles.

Technological innovation is therefore an essential and differentiating factor permitting the Telecom Italia Group to develop a competitive advantage and maintain leadership in an increasingly competitive market.

The technological and innovative advances the Group has made over the years in the design, development and adoption of state-of-the-art networks, terminals and services, has also been utilized in foreign countries where the Group operates through subsidiaries.

Technological research and development activities are carried out by the operational and business units (Network, Market, Information Technology, Web & Media and Security) as well as by Olivetti in addition to the Innovation & Engineering Services department (former Telecom Italia Lab) of Operations where all the activities and competences concerning basic research, the assessment of developing technologies and the intra-moenia development are concentrated.

The technological research and development of Telecom Italia Group arises moreover from the strategic partnerships with the most important manufacturers of telecommunication equipment and systems and with research centers of excellence in the most qualified academic institutions both at the national and international level.

Technological research and development activities range from reviews of basic technologies, aimed at increasing network and system efficiency, to complex activities involving the radical review of platforms, services and architectures; the effort concentrated on the field by business unit operational departments is therefore essential to assure the compliance of new services with customer needs and the continuous improvement of service quality.

During 2006, the innovative investments of Telecom Italia Group in tangible and intangible assets were approximately 3,200 million. Internal resources devoted to these activities as well as to research, in Italy, and Brazil, comprise approximately 6,300 employees, with an overall commitment equal to about 540 million (of which about 130 million is already included in the investments).

Total research and development costs incurred in 2006 amounted to approximately 133 million (180 million in 2005 and 181 million in 2004) and included external costs, labor costs of dedicated staff and depreciation and amortization.

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**5.8 CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE THREE YEAR PERIOD ENDED DECEMBER 31, 2006 RECONCILIATION OF IFRS TO U.S. GAAP**

During the three years ended December 31, 2006, 2005 and 2004, the Telecom Italia Group engaged in certain significant transactions which, under U.S. GAAP, gave rise to material differences in net income and equity when compared to IFRS. In addition, the application of the IFRS first time adoption at the transition date (January 1, 2004), as well as of certain U.S. GAAP accounting principles, led to material adjustments to IFRS net income and equity. In particular, the most significant differences arose from the following:

- business combinations prior to the adoption of IFRS;
- TIM Acquisition of Minority Interest in 2005;
- rationalization of the Group's Internet operations;
- sale of real estate properties (Magnum Project);
- different basis of reference for the impairment test of goodwill (Cash Generating Unit under IFRS and Reporting Unit under U.S. GAAP);
- capitalization of interest on assets under construction under U.S. GAAP (under IFRS, as permitted, Telecom Italia has elected to charge interest to the statement of income);
- deferred taxes on tax suspension equity reserves.

As a result of the foregoing elements there are material differences in reconciling Net income attributable to equity holders of the Parent for the three-year period ended December 31, 2006 under IFRS and Equity attributable to equity holders of the Parent as of December 31, 2006 and 2005 under IFRS to U.S. GAAP relevant amounts. The following is a discussion of the U.S. GAAP treatment of such transactions and the application of the described U.S. GAAP accounting principles and the impact on Net income attributable to equity holders of the Parent under IFRS for the three-year period ended December 31, 2006 and Equity attributable to equity holders of the Parent under IFRS as of December 31, 2006 and 2005. For a complete description of the Telecom Italia Group's reconciliation and other required U.S. GAAP disclosures see Notes 46, 47, and 48 of the Notes to the 2006 Consolidated Financial Statements included elsewhere herein.

**5.8.1 YEAR ENDED DECEMBER 31, 2006*****Net income attributable to equity holders of the Parent***



Under IFRS, Net income attributable to equity holders of the Parent was 3,014 million in 2006, compared to net income of 1,862 million under U.S. GAAP. The decrease in net income of 1,152 million is largely attributable to certain of the transactions as well as the application of certain of the U.S. GAAP accounting principles described above which resulted in material adjustments to the IFRS results. The most significant items affecting the 2006 results are as follows:

- *business combinations prior to the adoption of IFRS:* Telecom Italia elected not to apply IFRS 3 *Business Combinations*, to prior year business combinations (which mainly include Old Telecom Italia acquisitions that occurred in the period 1999-2003) as allowed by IFRS 1 *First-time Adoption of International Financial Reporting Standards*. As a result, under IFRS, certain differences relating to business combinations prior to 2004 were accounted for as a pooling of interest or on the basis of book values (for both assets acquired and shares issued). U.S. GAAP requires that the assets and liabilities purchased be recorded at fair value for all business combinations. As a result, these transactions gave rise to classes of assets, in particular tangible and intangible assets besides goodwill, that are being amortized with an increase in depreciation and amortization expense of 789 million. Moreover, due to the sale and leaseback transitions on assets, 174 million of prior year purchase allocation on real estate assets has been written off on disposal of the related assets;
- *TIM Acquisition of Minority Interest in 2005:* during 2005, the Group acquired the outstanding minority interest in TIM through a Cash Tender Offer, other purchases in the market and the merger with and into Telecom Italia. Under IFRS such transactions were accounted for under the parent-entity extension method which gave rise to an increase in goodwill. Under U.S. GAAP, which requires the application of the purchase method and step acquisition accounting, the price allocation resulted in the

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recognition of a reduction of goodwill due to the allocation of the purchase price to the fair value of the Group's share of identifiable intangible assets acquired and an increase in amortization expense of 686 million for the year;

- *tax effect on reconciling items:* in 2006 the additional tax benefit of 624 million recorded for U.S. GAAP related mainly to the additional amortization and depreciation expense recorded for intangible and tangible assets described above;
- *discontinued operations/assets held for sale:* an additional net income of 105 million in 2006 was recorded under U.S. GAAP entirely relating to the disposal of the subsidiary Digitel Venezuela. The disposal of Digitel Venezuela led to the reversal to the statement of income of the cumulative translation adjustments which under IFRS first time adoption were recognized only from January 1, 2004.

***Equity attributable to equity holders of the Parent***

Equity attributable to equity holders of the Parent, under IFRS was 26,018 million at December 31, 2006, compared to 43,823 million for U.S. GAAP. The overall impact of the U.S. GAAP adjustments was to increase equity attributable to equity holders of the Parent by 17,805 million. The most significant items affecting this increase are as follows:

- *business combinations prior to the adoption of IFRS:* as explained above in more details U.S. GAAP requires that the assets and liabilities purchased be recorded at fair value for all business combinations. As a result, these transactions gave rise to classes of assets, in particular tangible and intangible assets, that are being amortized, as well as goodwill. The application of this accounting treatment resulted in an increase of 21,790 million of the equity (gross of minority interests and taxes) as of December 31, 2006;
- *TIM Acquisition of Minority Interest in 2005:* as explained above in more detail, under U.S. GAAP, which requires the application of the purchase method and step acquisition accounting, the price allocation resulted in the recognition of a reduction of goodwill due to the allocation of the purchase price to the fair value of the Group's share of identifiable intangible assets acquired and an increase in amortization expense for the year. Such accounting treatment resulted in an increase of 2,430 million of the equity (gross of minority interests and taxes) as of December 31, 2006;
- *capitalization of interest:* under IFRS, Telecom Italia has elected not to capitalize interest on assets under construction. U.S. GAAP requires interest to be capitalized on both tangible and intangible assets regardless of whether specific borrowings relate to the project. The capitalized interest is amortized over the remaining useful life of the assets. A large part of the interest capitalized prior to 2004 relates to the UMTS license of TIM which was put into use in 2004 and on which amortization expense has been calculated commencing in 2004. Such different accounting treatment resulted in an increase of 717 million of the equity (gross of minority interests and taxes) as of December 31, 2006;
- *deferred taxes on tax-suspension equity reserves:* under IFRS, IAS 12 *Income taxes*, allows, under certain conditions, not to record deferred income taxes on tax suspension equity reserves, whereas, under U.S. GAAP, SFAS 109 *Accounting for Income Taxes* provides that deferred taxes, in any case, shall be provided. Such different accounting treatment resulted in an increase in deferred tax liability and consequently a decrease of 257 million of equity as of December 31, 2006;
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*tax effect on reconciling items:* these effects resulted in a decrease of 7,078 million in equity (gross of minority interests) as of December 31, 2006, and mainly relate to additional tangible and intangible assets (excluding goodwill) arising from the above business combinations.

Total liabilities under IFRS were 62,359 million versus 70,449 million (excluding minority interests) for U.S. GAAP. In particular, excluding financial liabilities relating to discontinued operations/assets held for sale, non-current financial liabilities were 41,712 million under U.S. GAAP at the end of 2006, versus 40,803 million under IFRS, with an increase of 909 million under U.S. GAAP. Such increase mainly arose from:

- the different accounting treatment of some aspects of real estate transactions entered into by the Telecom Italia Group, mainly in previous years. Under IFRS, such transactions have been recorded in accordance with the finance method, except for the land element which, in absence of a contractual

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purchase option or passage of title to Telecom Italia, was treated as an operating lease. Such accounting treatment was also followed under U.S. GAAP except for the land element which, when less than 25% of the fair value of the property, was treated as a finance lease with an additional increase in debt. The additional debt amounts to 660 million;

- the application of the purchase accounting method to the Old Telecom Italia Acquisition under U.S. GAAP, which led to the valuation of liabilities at fair values and an increase of debt of 130 million.

**5.8.2 YEAR ENDED DECEMBER 31, 2005*****Net income attributable to equity holders of the Parent***

Under IFRS, Net income attributable to equity holders of the Parent was 3,216 million in 2005, compared to net income of 1,939 million under U.S. GAAP. The decrease in net income of 1,277 million is largely attributable to certain of the transactions as well as the application of certain of the U.S. GAAP accounting principles described above which resulted in material adjustments to the IFRS results. The most significant items affecting the 2005 results are as follows:

- *business combinations prior to the adoption of IFRS:* as a result of the accounting treatment described above under 5.8.1 Year Ended December 31, 2006 there was an increase in depreciation and amortization expense of 860 million. Moreover, due to the sale and leaseback transactions on assets, 366 million of prior year purchase allocation on real estate assets has been written off on disposal of the related assets;
- *TIM Acquisition of Minority Interest in 2005:* due to the accounting treatment described above for the TIM acquisition, the price allocation resulted in the recognition of a reduction of goodwill due to the allocation of the purchase price to the fair value of the Group's share of identifiable intangible assets acquired and an increase in amortization of 529 million for the year;
- *tax effect on reconciling items:* in 2005 the additional tax benefit of 558 million recorded for U.S. GAAP related mainly to the additional amortization and depreciation expense recorded for intangible and tangible assets described above;
- *discontinued operations/assets held for sale:* an additional net loss of 175 million in 2005 was recorded under U.S. GAAP almost entirely relating to the disposal of the subsidiaries Entel Chile and TIM Perù. Such disposals led to the reversal to the statement of income of the cumulative translation adjustments which under IFRS first time adoption were recognized only from January 1, 2004.

***Equity attributable to equity holders of the Parent***

Equity, attributable to equity holders of the Parent, under IFRS was 25,662 million at December 31, 2005, compared to 44,631 million for U.S. GAAP. The overall impact of the U.S. GAAP adjustments was to increase Equity attributable to equity holders of the Parent by 18,969 million. The most significant items affecting this increase are as follows:

- *business combinations prior to the adoption of IFRS:* as explained above in more detail, U.S. GAAP requires that the assets and liabilities purchased be recorded at fair value for all business combinations. As a result, these transactions gave rise to classes of assets, in particular tangible and intangible assets, that are being amortized, as well as goodwill. The application of this accounting treatment resulted in an increase of 22,592 million of the equity (gross of minority interests and taxes) as of December 31, 2005;
- *TIM Acquisition of Minority Interest in 2005:* as explained above in more detail, under U.S. GAAP, which requires the application of the purchase method and step acquisition accounting, the price allocation resulted in the recognition of a reduction of goodwill due to the allocation of the purchase price to the fair value of the Group's share of identifiable intangible assets acquired and an increase in amortization for the year. Such accounting treatment resulted in an increase of 3,075 million of the equity (gross of minority interests and taxes) as of December 31, 2005;
- *rationalization of the Group's Internet operations:* as described in Note 3 of the Notes to the 2006 Consolidated Financial Statements included elsewhere herein, under IFRS, the acquisition in 2005 of the Internet business from Telecom Italia Media was treated as a transaction among shareholders, and the

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difference between the price paid and the share of the underlying net assets acquired ( 364 million) was included as a movement of equity. Under U.S. GAAP, the acquisition has been accounted for under the purchase method and the excess of the purchase price over the share of net assets acquired was allocated to brand name, customer list and other intangibles for a total amount of approximately 285 million and to goodwill for approximately 83 million. Such different accounting treatment resulted in an increase of 346 million of the equity (gross of minority interests and taxes) as of December 31, 2005;

- *capitalization of interest:* as a result of the treatment of capitalized interest, under U.S. GAAP there was an increase of 752 million of the equity (gross of Minority Interests and taxes) as of December 31, 2005, a large part of the interest capitalized prior to 2004 relates to the UMTS license of TIM which was put into use in 2004 and on which amortization expense has been calculated commencing in 2004;
- *deferred taxes on tax-suspension equity reserves:* under IFRS, IAS 12 *Income taxes*, allows, under certain conditions, not to record deferred income taxes on tax suspension equity reserves, whereas, under U.S. GAAP, SFAS 109 *Accounting for Income Taxes* provides that deferred taxes, in any case, shall be provided. Such different accounting treatment resulted in an increase in deferred tax liability and consequently a decrease of 257 million of equity as of December 31, 2005;
- *tax effect on reconciling items:* these effects resulted in a decrease of 7,694 million in equity (gross of minority interests) as of December 31, 2005, and mainly relate to additional tangible and intangible assets (excluding goodwill) arising from the above business combinations.

Total liabilities under IFRS were 69,025 million versus 77,327 million (excluding minority interests) for U.S. GAAP. In particular, excluding financial liabilities relating to discontinued operations/assets held for sale, non-current financial liabilities were 43,065 million under U.S. GAAP at the end of 2005, versus 42,146 million under IFRS, with an increase of 919 million under U.S. GAAP. Such increase mainly arose from:

- the different accounting treatment of some aspects of real estate transactions entered into by the Telecom Italia Group, mainly in previous years. Under IFRS, such transactions have been recorded in accordance with the finance method, except for the land element which, in absence of a contractual purchase option or passage of title to Telecom Italia, was treated as operating lease. Such accounting treatment was also followed under U.S. GAAP except for the land element which, when less than 25% of the fair value of the property, was treated as finance lease with an additional increase in debt. The additional debt amounts to 575 million;
- the application of the purchase accounting method to the Old Telecom Italia Acquisition under U.S. GAAP, which led to the valuation of liabilities at fair values and an increase of debt of 259 million.

**5.8.3 YEAR ENDED DECEMBER 31, 2004*****Net income attributable to equity holders of the Parent***

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Under IFRS, Net income attributable to equity holders of the Parent was 1,815 million in 2004, compared to net income of 1,541 million under U.S. GAAP. The decrease in net income under U.S. GAAP of 274 million is largely attributable to certain of the transactions as well as the application of certain of the U.S. GAAP accounting principles described above which resulted in material adjustments to the IFRS results. The most significant items affecting the 2004 results are as follows:

- *business combinations prior to the adoption of IFRS:* as a result of the o the accounting treatment described above under 5.8.1 Year Ended December 31, 2006, there was an increase in depreciation and amortization expense for the year of 978 million;
- *reversal of goodwill impairment:* to evaluate and account for impairments of depreciable assets or assets to be disposed of, the Group follows the guidance provided in SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* which provides, in particular, that carrying values shall be firstly compared with undiscounted cash flows.

Furthermore, to test for impairment goodwill is allocated, under IFRS, at the date of acquisition, to each cash-generating units or groups of cash-generating units which are expected to benefit from the acquisition. Allocation is made to the lowest level at which goodwill is monitored for management

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purposes, which is never at a higher level than that of the business segments determined in accordance with IAS 14 *Segment Reporting*. Under U.S. GAAP, the Group ceased amortizing goodwill on January 1, 2002, upon the adoption of SFAS 142, *Goodwill and Other Intangible Assets*, whereas under IFRS first time adoption the Group ceased amortizing goodwill on January 1, 2004.

As explained in more detail in Note 46.1 of the Notes to the Consolidated Financial Statements, in accordance with SFAS 142, the first step in the test for impairment of goodwill is to identify potential impairment by comparing the fair value of a reporting unit (which encompasses a wider meaning than cash generating unit adopted by IFRS) with its carrying amount, including goodwill. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of the loss, if any. The second part compares the implied value of the reporting unit's goodwill to the carrying amount of that goodwill. The excess of the carrying value over the implied value is then written-off in the period. Implied value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination.

As a result, certain impairment losses recorded under IFRS were deemed not necessary under U.S. GAAP and therefore have been reversed to the statement of income with a positive effect on income of 438 million;

- *tax effect on reconciling items:* in 2004 the additional tax benefit of 334 million recorded for U.S. GAAP related mainly to the additional amortization and depreciation expense recorded for intangible and tangible assets described above in connection with the above business combinations and acquisitions;
- *minority interests on reconciling items:* the negative impact on income in accordance with U.S. GAAP of 186 million relates mainly to the reversal of goodwill impairment as above and to other minor U.S. GAAP adjustments.



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**Cautionary Statement For Purposes Of The Safe Harbor Provisions Of The United States Private Securities Litigation Reform Act Of 1995**

**5.9 CAUTIONARY STATEMENT FOR PURPOSES OF THE SAFE HARBOR PROVISIONS OF THE UNITED STATES PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. The foregoing discussion in Item 5. Operating and Financial Review and Prospects and the following discussion under Item 5.10. Quantitative and Qualitative Disclosures About Market Risks contain forward-looking statements. Forward-looking statements are statements that are not historical facts and can be identified by the use of forward-looking terminology such as believes, may, is expected to, will continue, should, seeks or anticipates or similar expressions or the negative thereof or other comparable terminology, or by the forward-looking nature of discussions of strategy, plans or intentions.

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

- the continuing impact of increased competition in a liberalized market, including competition from longer established domestic competitors and global and regional alliances formed by other telecommunications operators in our core Italian domestic fixed-line and wireless markets;
- our ability to introduce new services to stimulate increased usage of our fixed and wireless networks to offset declines in the traditional fixed-line voice business due to the continuing impact of regulatory required price reductions, market share loss, pricing pressures generally and shifts in usage patterns;
- the level of demand for telecommunications services, particularly wireless telecommunications services in the maturing Italian market and for new higher value added products and services such as broadband;
- our ability to achieve the planned synergies expected to be generated by the convergence between fixed telephony, mobile, broadband internet and media content including in expenses, capital expenditures and capacity to launch new convergent services;
- the success of our customer loyalty and retention programs and the impact of such programs on our revenues;
- our ability to successfully implement our Internet and broadband strategy both in Italy and abroad;
- our ability to successfully achieve our debt reduction targets;
- the impact of regulatory decisions and changes in the regulatory environment in Italy and other countries in which we operate;
- the impact of economic development generally on our international business and on our foreign investments and capital expenditures;

- the continuing impact of rapid or disruptive changes in technologies;
- the impact of political and economic developments in Italy and other countries in which we operate;
- the impact of fluctuations in currency exchange and interest rates;
- our ability to successfully implement our strategy over the 2007-2009 period;
- our ability to achieve the expected return on the investments and capital expenditures we have made and continue to make in Brazil on mobile and in Europe on broadband;
- our ability to successfully strengthen our business and exploit new adjacent markets, such as Pay-TV and IT services;
- the amount and timing of any future impairment charges for our licenses, goodwill or other assets;
- the outcome of litigation, disputes and investigations in which we are involved or may become involved; and
- decreased mobile communications usage arising from actual or perceived health risks or other problems relating to mobile handsets or transmission masts.

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

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

**Quantitative And Qualitative Disclosures About Market Risks**

**5.10 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS**

The following discussion should be read in conjunction with the Note 2 Accounting Policies , Note 4 Financial Risk management , Note 24 Financial Instruments and Note 48 Additional U.S. GAAP Disclosures of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report.

Derivative financial instruments are used by the Telecom Italia Group to manage its exposure to foreign exchange rate and interest rate risks and to diversify the parameters of debt so that costs and volatility can be reduced to within prefixed operational limits.

Derivative financial instruments at December 31, 2006 are principally used by the Group for the management of its debt positions. They include interest rate swaps (IRS) to reduce interest rate exposure on fixed-rate and floating-rate bank loans and bonds and cross currency and interest rate swaps (CCIRS) and currency forwards to convert the loans secured in different foreign currencies to the functional currencies of the various companies of the Group.

IRSs involve, at specified maturity dates, the exchange of flows of interest calculated on the notional amount at the agreed fixed or floating rates, with the counterparties.

The same also applies to CCIRSs which, in addition to the settlement of periodic interest flows, can involve the exchange of principal, in the respective currencies of denomination, at maturity and, if necessary, at another date.

Although a small number of derivatives have not been designated for hedge accounting treatment under FAS 133 and IAS 39, such derivatives are related to an underlying liability in all cases, therefore providing an economic hedge despite the accounting designation and treatment (please see 5.10.3 Financial Instruments ). Consequently management believes that Telecom Italia s use of derivatives is not speculative.

**5.10.1 DEBT POLICY**

Telecom Italia Group s debt used to support the financing of its domestic and international businesses contains an element of market risk from changes in interest and currency rates. With respect to interest rates applicable to medium and long-term debt, Telecom Italia Group s policy is to utilize a defined ratio of floating rate and fixed rate debt with a different range of maturities. Telecom Italia Group s policy is intended to optimize the cost of funding/risk exposure mix, utilizing as providers of funds domestic and international capital markets and supranational agencies such as the European Investment Bank. Telecom Italia Group policies address the use of financial derivatives, including the approval of counterparties and the investment of excess liquidity. These policies are intended to minimize financial risks and obtain more favorable terms from the counterparties. In addition, Telecom Italia has a centralized treasury that provides financial assistance to its subsidiaries worldwide and usually operates as the Telecom Italia Group s main banker, allocating resources according to needs. The centralized treasury also gives support in negotiating credit lines and financial operations in general.

The table below sets forth, for the periods indicated, the aggregate nominal amount of total long-term financial liabilities (including current portion and leases payable/long rent and excluding discontinued operations/assets held for sale) due in each year through 2011 and thereafter.

|                                     | Amounts due in the year ended December 31, |              |              |              |              |               | Total as of          |
|-------------------------------------|--|--------------|--------------|--------------|--------------|---------------|----------------------|
|                                     | 2007                                       | 2008         | 2009         | 2010         | 2011         | Thereafter    | December 31,<br>2006 |
|                                     | (millions of Euro)                         |              |              |              |              |               |                      |
| Fixed Rate financial liabilities    | 3,310                                      | 1,864        | 3,992        | 3,728        | 2,875        | 15,005        | 30,774               |
| Floating Rate financial liabilities | 533  | 2,594        | 247          | 1,734        | 1,733        | 6,752         | 13,593               |
| <b>Total</b>                        | <b>3,843</b>                               | <b>4,458</b> | <b>4,239</b> | <b>5,462</b> | <b>4,608</b> | <b>21,757</b> | <b>44,367</b>        |

As of December 31, 2006, the fair value of such outstanding debt amounted to approximately 44,716 million. The financial debt's market value is estimated on the basis of the present value as of December 31, 2006 of the future cash flows.

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The table below sets forth, for the periods indicated, the aggregate nominal amount of long-term debt outstanding at December 31, 2006 (excluding current portion of long-term debt and leases payable/long rent) and the average interest rate, broken down into fixed and floating.

|   | Amounts due in the year ended December 31, |               |               |               |               |               |               |
|---|--|---------------|---------------|---------------|---------------|---------------|---------------|
|   | 2007                                       | 2008          | 2009          | 2010          | 2011          | 2012          | Thereafter    |
|   | (millions of Euro, except percentages)     |               |               |               |               |               |               |
| Long-Term Fixed Rate Debt                                 | 19,922                                     | 18,235        | 14,497        | 13,896        | 11,127        | 8,863         | 6,484         |
| Average Fixed Rate  | 5.71%                                      | 5.70%         | 5.63%         | 5.81%         | 5.64%         | 5.38%         | 5.20%         |
| Long-Term Floating Rate Debt Swapped into Fixed Rate Debt | 5,742                                      | 5,742         | 5,632         | 2,632         | 2,632         | 132           | 132           |
| Average Swapped into Fixed Rate                           | 3.39%                                      | 3.39%         | 3.36%         | 3.69%         | 3.69%         | 4.21%         | 4.21%         |
| Average Total Fixed Rate                                  | 5.31%                                      | 5.15%         | 4.99%         | 5.47%         | 5.27%         | 5.36%         | 5.18%         |
| <b>Total Fixed Rate Debt</b>                              | <b>25,664</b>                              | <b>23,977</b> | <b>20,129</b> | <b>16,528</b> | <b>13,759</b> | <b>8,995</b>  | <b>6,616</b>  |
| Long-Term Floating Rate Debt                              | 5,354                                      | 3,531         | 3,309         | 3,082         | 1,943         | 1,831         | 1,253         |
| Average Floating Rate                                     | 4.66%                                      | 4.65%         | 4.17%         | 4.05%         | 4.20%         | 3.93%         | 3.75%         |
| Long-Term Fixed Rate Debt Swapped into Floating Rate Debt | 7,659                                      | 6,897         | 6,884         | 5,391         | 4,809         | 4,801         | 4,799         |
| Average Swapped into Floating Rate                        | 3.65%                                      | 3.48%         | 3.46%         | 3.59%         | 3.65%         | 3.64%         | 3.64%         |
| Average Total Floating Rate                               | 4.07%                                      | 3.88%         | 3.69%         | 3.76%         | 3.81%         | 3.72%         | 3.66%         |
| <b>Total Floating Rate Debt</b>                           | <b>13,013</b>                              | <b>10,428</b> | <b>10,193</b> | <b>8,473</b>  | <b>6,752</b>  | <b>6,632</b>  | <b>6,052</b>  |
| <b>Total Long-Term Debt</b>                               | <b>38,677</b>                              | <b>34,405</b> | <b>30,322</b> | <b>25,001</b> | <b>20,511</b> | <b>15,627</b> | <b>12,668</b> |

As of December 31, 2006, approximately 68% of Telecom Italia Group's long-term debt was denominated in Euro, while the remainder, 13,043 million, was denominated in foreign currencies primarily U.S.\$, Pound Sterling, Brazilian Reals and Japanese Yen. After taking into account the Company's derivative financial instruments, the Company's long-term debt is not materially exposed to fluctuations in foreign exchange rates. At December 31, 2006, approximately 30% of the long-term debt (including current portion) carried a floating rate.

**5.10.2 MARKET RISK POLICY**

Telecom Italia Group's policies regarding market risk consist of the following:

- the Finance Department advises on the maximum level of interest rate risk to which the Telecom Italia Group should be exposed, to an internal committee which meets on a regular basis in order to monitor the activities and the level and

value of the current market risk exposures; the Centralized Treasury, operating as a service center, within the Finance Department supplies financial services and actively supports our subsidiaries according to their requirements and local circumstances;

- we use derivative financial instruments to manage these financial market risks, and have established policies to handle and mitigate the adverse effects of these exposures; and
- we continually evaluate the credit quality of counterparties to minimize the risk of non-performance. The counterparties to derivative contracts are generally highly rated banks and financial institutions and such counterparties are continually monitored in order to minimize the risk of non-performance.

For further details, please see Note 4 Financial Risk Management of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report.

### **5.10.3 FINANCIAL INSTRUMENTS**

#### **V INTEREST RATE AND FOREIGN EXCHANGE RISK MANAGEMENT**

We have established a set of guidelines in order to manage financial risks. In particular, an internal committee monitors exposure to market risks (both interest rate and foreign exchange risk), the use of financial derivatives for the management of those risks and credit risks. Counterparties in derivatives are banks and financial institutions having generally a rating not less than A- assigned by Standard & Poor's or an equivalent level assigned by other agencies, which is constantly monitored in order to minimize credit risk.

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

**Quantitative And Qualitative Disclosures About Market Risks**

We seek to diversify and minimize interest rate exposure of our operating and financing activities through portfolio diversification and, according to the evaluation of our exposures, selectively enter into derivatives instruments. Since our corporate objective is pursued through our commercial operations, i.e., the sale of telecommunications and media services, foreign exchange exposures are normally hedged, provided the risks would affect our cash flows.

The Telecom Italia Group is exposed to market risks as a result of changes in interest rates and exchange rates in the markets in which it operates or is present with bond issues, mainly Europe, the United States, Great Britain and Latin America.

The risk management policies of the Telecom Italia Group aim to diversify market risks and minimize interest rate exposure by suitable portfolio diversification, which is also implemented by using carefully selected derivative financial instruments.

The Group defines an optimum fixed-rate and floating-rate debt composition and uses derivative financial instruments to achieve that prefixed composition. Taking into account the Group's operations in various sectors, in terms of risk, volatility and the amount of expected operating cash flows, the optimum blend of medium/long-term non-current financial liabilities has been established at 70% for the fixed-rate component and 30% for the floating-rate component.

The Group mainly uses derivative financial instruments to manage market risks:

- Interest Rate Swaps (IRS) are used to modify the profile of the original exposure to interest rate risks on loans and bonds, whether fixed or floating;
- Cross Currency and Interest Rate Swaps (CCIRS) and Currency Forwards are used to convert loans and bonds issues in currencies other than the euro principally in U.S. dollars and British pounds to the functional currencies of the operating companies.

As a result of the above policies, at December 31, 2006, the exchange rate risk on the financial payables assumed by the Group denominated in currencies other than Euro is completely hedged.

To determine the market value of the financial derivatives, we use various pricing models. The market value of IRS and of CCIRS reflects the difference between the fixed rate to be paid/received and the interest rate (having the same expiration date as the swap) assessed on the basis of the market environment on the evaluation date. With regard to IRS the principal amount is not exchanged between the parties and therefore does not constitute a measure of exposure to credit risk, which is instead limited to the amount of interest or interest differentials to be received or paid at the interest payment date.

The market value of CCIRS also depends on the difference between the reference foreign exchange rate on the agreement date and the foreign exchange rate on the valuation date, since generally CCIRS involve the exchange of principal in the respective currencies of denomination at maturity and, if necessary, at another date, in addition to the settlement of periodic interest flows.





**Table of Contents****Item 5. Operating And Financial Review And Prospects****Quantitative And Qualitative Disclosures About Market Risks****v Telecom Italia Group Derivative Instruments**

As of December 31, 2006 the total notional amount of our derivative instruments amounted to 22,252 million, of which 21,880 million related to derivative instruments on debt positions and 372 million related to derivative instruments on financial assets and on short-term treasury operations, as detailed in the following table:

| Type of derivative  | Hedged Risk  | Notional amount     | Mark to Market Spot (Clean Price) as of December 31, 2006 |
|---|--|---------------------|---|
|   |  | (millions of Euro)  |   |
| Interest Rate Swaps   | Interest Rate Risk   |                     |   |
| Cross Currency and Interest Rate Swaps  | Interest Rate Risk and Foreign Currency Exchange Rate Risk | 8,623               | (787)   |
| <b>Fair Value Hedge Derivatives</b>   |  | <b>8,623</b>        | <b>(787)</b>  |
| Interest Rate Swaps   | Interest Rate Risk   | 4,230               | 102   |
| Cross Currency and Interest Rate Swaps  | Interest Rate Risk and Foreign Currency Exchange Rate Risk | 6,119               | (538)   |
| Forward and Forex Options   | Foreign Currency Exchange Rate Risk                        |                     |   |
| <b>Cash Flow Hedge Derivatives</b>  |  | <b>10,349</b>       | <b>(436)</b>  |
| Interest Rate Swaps   | Interest Rate Risk   | 2,878               | 5   |
| Cross Currency and Interest Rate Swaps  | Interest Rate Risk and Foreign Currency Exchange Rate Risk | 30                  | 1   |
| <b>Non-Hedge Accounting Derivatives</b>   |  | <b>2,908</b>        | <b>6</b>  |
| <b>Total Derivative Instruments on Debt Positions</b>                                   |  | <b>(a) 21,880</b>   | <b>(1,217)</b>  |
| Commodity Swaps   | Commodity Risk   | 89                  | (6)   |
| Forward and Forex Options   | Foreign Currency Exchange Rate Risk                        | 5                   |   |
| <b>Cash Flow Hedge Derivatives</b>  |  | <b>94</b>           | <b>(6)</b>  |
| Currency Forwards   | Foreign Currency Exchange Rate Risk                        | 278                 |   |
| <b>Non-Hedge Accounting Derivatives</b>   |  | <b>278</b>          |   |
| <b>Derivative Instruments on Financial Assets and on Short-term Treasury Operations</b> |  | <b>(b) 372</b>      | <b>(6)</b>  |
| <b>Total Telecom Italia Group Derivatives</b>   |  | <b>(a+b) 22,252</b> | <b>(1,223)</b>  |

- **DERIVATIVE INSTRUMENTS ON DEBT POSITIONS**

The following tables give a description of our financial derivative contracts outstanding as of December 31, 2006, to manage the debt positions. The notional amount is net of compounded derivatives. Whenever a derivative is set up on another derivative, the notional amount is reported once and the net effect of the two compounded derivatives is considered.

|   | Notional<br>amount at<br>12/31/2006 | Market value<br>of derivatives at<br>12/31/2006<br>(a) | Market value<br>of underlying<br>debt positions at<br>12/31/2006<br>(b) | Market value<br>of debt<br>including<br>related<br>derivatives at<br>12/31/2006<br>(c)=(b-a) | Market value<br>of<br>derivatives at<br>12/31/2005 |
|---|-------------------------------------|--|---|--|--|
|   |                                     |  | (millions of Euro)  |  |  |
| Interest rate swaps and interest rate options | 7,108                               | 107  | 7,108   | 7,001  | 6  |
| Cross-currency and interest rate swaps        | 14,772                              | (1,324)  | 13,497  | 14,821   | (468)  |
| <b>Total</b>                                  | <b>21,880</b>                       | <b>(*)(1,217)</b>                                      | <b>20,605</b>   | <b>21,822</b>  | <b>(*)(462)</b>                                    |

(\*) Most of the market value of derivatives is attributable to the currency exchange variations which are offset by the currency exchange variations on the underlying position.

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As of December 31, 2006, derivative instruments on debt positions are classified as follows by maturity:

|                               | 2007               | 2008 | 2009 | 2010  | 2011  | Thereafter | Total  | Market value of underlying debt position at 12/31/2006 |
|-------------------------------|--------------------|------|------|-------|-------|------------|--------|--|
|                               | (millions of Euro) |      |      |       |       |            |        |  |
| Derivatives on Debt Positions | 4,346              | 851  | 110  | 5,593 | 1,597 | 9,383      | 21,880 | 20,605   |

The following tables set forth a description of our financial derivative contracts outstanding as of December 31, 2006, used to hedge debt positions.

*INTEREST RATE SWAPS*

At December 31, 2006, Telecom Italia Group companies had IRS relating to financial liabilities recorded in the financial statements, for total principal equal to the notional amount of 7,108 million. Details of such contracts are set forth in the table below.

| Interest Rate Derivatives             | Maturities         |      |                     |                    |      |                     |              | Mark to Market |
|---------------------------------------|--------------------|------|---------------------|--------------------|------|---------------------|--------------|----------------|
|                                       | 2007               | 2008 | 2009                | 2010               | 2011 | Thereafter          | Total        |                |
|                                       | (millions of Euro) |      |                     |                    |      |                     |              |                |
| <b>EUR Interest Rate Swaps</b>        |                    |      |                     |                    |      |                     |              |                |
| <b>Receive variable, pay fixed</b>    |                    |      |                     |                    |      |                     |              |                |
| <i>Amount</i>                         | 2,798              |      | 110                 | 3,000              |      | 120                 | 6,028        | 99             |
| <i>Average pay rate</i>               | 3.91%              |      | 3.35%               | 3.09%              |      | 4.16%               |              |                |
| <i>Average receive rate</i>           | 6M Euribor         |      | 3M Euribor + 60 bps | 6M Euribor         |      | 3M Euribor + 66 bps |              |                |
| <i>Amount</i>                         |                    |      |                     | 1,000              |      |                     | 1,000        | 5              |
| <i>Average pay rate</i>               |                    |      |                     | 4.54%              |      |                     |              |                |
| <i>Average receive rate</i>           |                    |      |                     | 3M Euribor +53 bps |      |                     |              |                |
| <b>Sub-total</b>                      | <b>2,798</b>       |      | <b>110</b>          | <b>4,000</b>       |      | <b>120</b>          | <b>7,028</b> | <b>104</b>     |
| <b>EUR Interest Rate Swaps</b>        |                    |      |                     |                    |      |                     |              |                |
| <b>Receive variable, pay variable</b> |                    |      |                     |                    |      |                     |              |                |
| <i>Amount</i>                         | 22                 |      |                     |                    |      |                     | 22           | 0              |
| <i>Average pay rate</i>               | 6M Euribor         |      |                     |                    |      |                     |              |                |
| <i>Average receive rate</i>           | 3 bps              |      |                     |                    |      |                     |              |                |

|                                    | Rendiob,<br>Bot,<br>Rendistato (1) |           |            |              |          |            |              |            |  |
|------------------------------------|------------------------------------|-----------|------------|--------------|----------|------------|--------------|------------|--|
| <b>Reais Interest Rate Swaps</b>   |                                    |           |            |              |          |            |              |            |  |
| <b>Receive fixed, pay variable</b> |                                    |           |            |              |          |            |              |            |  |
| <i>Amount</i>                      | 14                                 | 13        | 10         | 9            | 7        | 5          | <b>58</b>    | <b>3</b>   |  |
| <i>Average pay rate</i>            | 74%                                | 73.7%     | 73.7%      | 73.6%        | 73.6%    | 72%        |              |            |  |
|                                    | CDI (2)                            | CDI (2)   | CDI (2)    | CDI (2)      | CDI (2)  | CDI (2)    |              |            |  |
| <i>Average receive rate</i>        | 11.30%                             | 11.30%    | 11.30%     | 11.30%       | 11.30%   | 11.30%     |              |            |  |
| <b>Total</b>                       | <b>2,834</b>                       | <b>13</b> | <b>120</b> | <b>4,009</b> | <b>7</b> | <b>125</b> | <b>7,108</b> | <b>107</b> |  |

(1) Rolint, Robot, Rendint and Rendiob are customary domestic Italian parameters for medium / long term debt.

(2) The CDI is the customary domestic Brazilian measure of overnight interest rate. As of December 31, 2006 this rate was around 13.17%.

For a further discussion of interest rate swaps see Note 4, Financial Risk Management of our Notes to our Consolidated Financial Statements included elsewhere in this Annual Report.

**Table of Contents****Item 5. Operating And Financial Review And Prospects****Quantitative And Qualitative Disclosures About Market Risks***Cross-Currency And Interest Rate Swaps And Currency Forwards*

At December 31, 2006, Telecom Italia Group companies had CCIRS contracts relating to financial liabilities recorded in the financial statements, for total principal equal to a notional amount of 14,772 million. Details of such contracts are set forth in the table below. References to JPY are to Japanese Yen and BRL to Brazilian Real.

| <b>Maturities</b>  |             |             |             |              |             |                   |                                 |
|--|-------------|-------------|-------------|--------------|-------------|-------------------|---------------------------------|
| <b>Foreign Exchange Derivatives</b>  | <b>2007</b> | <b>2008</b> | <b>2009</b> | <b>2010</b>  | <b>2011</b> | <b>Thereafter</b> | <b>Mark to<br/>Total Market</b> |
| (millions of Euro)   |             |             |             |              |             |                   |                                 |
| <b>CCIRS</b>   |             |             |             |              |             |                   |                                 |
| <b>Receive fixed USD, pay variable Euro</b>  |             |             |             |              |             |                   |                                 |
| <i>Amount</i>  |             | 850         |             | 1,014        | 593         | 1,817             | 4,274 (421)                     |
| <i>Average pay rate</i>  |             | 3M Euribor  |             | 6M Euribor   | 6M Euribor  | 6M Euribor        |                                 |
|  |             | +53 bps     |             | +41 bps      | +71 bps     | +83 bps           |                                 |
| <i>Average receive rate</i>  |             | 4.0%        |             | 4.0%         | 6.2%        | 5.4%              |                                 |
| <i>Amount</i>  |             |             |             | 579          |             | 1,156             | 1,735 (194)                     |
| <i>Average pay rate</i>  |             |             |             | 6M Euribor   |             | 6M Euribor        |                                 |
|  |             |             |             | +55 bps      |             | +75 bps           |                                 |
| <i>Average receive rate</i>  |             |             |             | 4.88%        |             | 5.25%             |                                 |
| <b>Sub-total</b>   |             | <b>850</b>  |             | <b>1,593</b> | <b>593</b>  | <b>2,973</b>      | <b>6,009 (615)</b>              |
| <b>Receive fixed USD, pay fixed Euro</b>   |             |             |             |              |             |                   |                                 |
| <i>Amount</i>  |             |             |             |              |             | 791               | 791 (22)                        |
| <i>Average pay rate</i>  |             |             |             |              |             | 5.88%             |                                 |
| <i>Average receive rate</i>  |             |             |             |              |             | 7.2%              |                                 |
| <i>Amount</i>  |             |             |             |              |             | 849               | 849 (202)                       |
| <i>Average pay rate</i>  |             |             |             |              |             | 6.00%             |                                 |
| <i>Average receive rate</i>  |             |             |             |              |             | 6.38%             |                                 |
| <i>Amount</i>  |             |             |             |              |             | 1,709             | 1,709 (267)                     |
| <i>Average pay rate</i>  |             |             |             |              |             | 5.04%             |                                 |
| <i>Average receive rate</i>  |             |             |             |              |             | 5.25%             |                                 |
| <b>Sub-total</b>   |             |             |             |              |             | <b>3,349</b>      | <b>3,349 (491)</b>              |
| <b>Receive dual currency (fixed USD rate, JPY principal at maturity), pay fixed Euro</b> |             |             |             |              |             |                   |                                 |
| <i>Amount</i>  |             |             |             |              |             | 174               | 174 (72)                        |
| <i>Average pay rate</i>  |             |             |             |              |             | 6.94%             |                                 |
| <i>Average receive rate</i>  |             |             |             |              |             | 5.00%             |                                 |
| <b>Receive fixed Yen, pay variable Euro</b>  |             |             |             |              |             |                   |                                 |
| <i>Amount</i>  |             |             |             |              |             | 171               | 171 (80)                        |
| <i>Average pay rate</i>  |             |             |             |              |             | 6M Euribor        |                                 |
|  |             |             |             |              |             | + 246 bps         |                                 |
| <i>Average receive rate</i>  |             |             |             |              |             | 3.55%             |                                 |

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| <b>Receive variable USD, pay variable Euro</b> |                            |  |                             |                   |
|--|----------------------------|--|-----------------------------|-------------------|
| <i>Amount</i>                                  | 150                        |  | 333                         | 483 (43)          |
| <i>Average pay rate</i>                        | 3M Euribor<br>-4 bps       |  | 6M Euribor<br>+ 56 bps      |                   |
| <i>Average receive rate</i>                    | 3M USD<br>Libor<br>- 7 bps |  | 3M USD<br>Libor<br>+ 48 bps |                   |
| <i>Amount</i>                                  |                            |  | 671                         | 671 (26)          |
| <i>Average pay rate</i>                        |                            |  | 6M Euribor<br>+ 71 bps      |                   |
| <i>Average receive rate</i>                    |                            |  | 3M USD<br>Libor<br>+ 61 bps |                   |
| <b>Sub-total</b>                               | <b>150</b>                 |  | <b>1,004</b>                | <b>1,154 (69)</b> |

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

| Foreign Exchange Derivatives                | Maturities                                  |   |              |              |              |               | Total          | Mark to Market |
|---|---|---|--------------|--------------|--------------|---------------|----------------|----------------|
|   | 2007  | 2008  | 2009         | 2010         | 2011         | Thereafter    |                |                |
|   | (millions of Euro)                          |   |              |              |              |               |                |                |
| <b>CCIRS</b>                                |   |   |              |              |              |               |                |                |
| <b>Receive fixed GBP, pay variable Euro</b> |   |   |              |              |              |               |                |                |
| Amount                                      | 685   |   |              |              |              |               | 685            | (15)           |
| Average pay rate                            | 6M Euribor                                  |   |              |              |              |               |                |                |
|   | +67 bps                                     |   |              |              |              |               |                |                |
| Average receive rate                        | 6.375%                                      |   |              |              |              |               |                |                |
| Amount                                      | 604   |   |              |              |              |               | 604            | (8)            |
| Average pay rate                            | 3M Euribor                                  |   |              |              |              |               |                |                |
|   | +73 bps                                     |   |              |              |              |               |                |                |
| Average receive rate                        | 6.375%                                      |   |              |              |              |               |                |                |
| <b>Sub-total</b>                            | <b>1,289</b>                                |   |              |              |              |               | <b>1,289</b>   | <b>(23)</b>    |
| <b>Receive fixed GBP, pay fixed Euro</b>    |   |   |              |              |              |               |                |                |
| Amount                                      |   |   |              |              |              | 751           | 751            | 13             |
| Average pay rate                            |   |   |              |              |              | 4.34%         |                |                |
| Average receive rate                        |   |   |              |              |              | 5.63%         |                |                |
| Amount                                      |   |   |              |              |              | 587           | 587            | (3)            |
| Average pay rate                            |   |   |              |              |              | 5.53%         |                |                |
| Average receive rate                        |   |   |              |              |              | 5.88%         |                |                |
| Amount                                      |   |   |              |              |              | 1,258         | 1,258          | 15             |
| Average pay rate                            |   |   |              |              |              | 5.31%         |                |                |
| Average receive rate                        |   |   |              |              |              | 6.38%         |                |                |
| <b>Sub-total</b>                            |   |   |              |              |              | <b>2,596</b>  | <b>2,596</b>   | <b>25</b>      |
| <b>Receive fixed USD, pay variable BRL</b>  |   |   |              |              |              |               |                |                |
| Amount                                      | 23  | 1   |              |              |              |               | 24             | 1              |
| Average pay rate                            | 115.2%<br>CDI (1)                           | 128.3%<br>CDI (1)                           |              |              |              |               |                |                |
| Average receive rate                        | Exchange rate<br>variation +<br>5.8% spread | Exchange rate<br>variation +<br>8.4% spread |              |              |              |               |                |                |
| <b>Receive fixed JPY, pay variable BRL</b>  |   |   |              |              |              |               |                |                |
| Amount                                      | 6   |   |              |              |              |               | 6              | 0              |
| Average pay rate                            | 109%<br>CDI (1)                             |   |              |              |              |               |                |                |
| Average receive rate                        | Exchange rate<br>variation +<br>0.1% spread |   |              |              |              |               |                |                |
| <b>Total</b>                                | <b>1,468</b>                                | <b>851</b>                                  | <b>1,593</b> | <b>1,597</b> | <b>9,263</b> | <b>14,772</b> | <b>(1,324)</b> |                |

(1) The CDI is the customary domestic Brazilian measure of overnight interest rate. As of December 31, 2006 this rate was around 13.17%.

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

- DERIVATIVE INSTRUMENTS ON FINANCIAL ASSETS AND ON SHORT-TERM TREASURY OPERATIONS**

The Telecom Italia Group also entered into derivative contracts to manage the interest rate and foreign currency risk on treasury operations for a nominal amount of approximately 372 million.

| <u>Description</u>  | <u>Equivalent<br/>notional<br/>amount</u> |
|---|---|
|   | <u>(millions<br/>of Euro)</u>             |
| <b>Non Hedge Accounting</b>                                   |   |
| Commodity Swaps (Telecom Italia S.p.A.)                       | 89  |
| Forward and Forex Options (Telecom Media News S.p.A.)         | 5   |
| Currency Forward transactions (Telecom Italia Finance S.A.).  | 186                                       |
| Currency Forward transactions (Telecom Italia S.p.A.).        | 37  |
| Currency Forward transactions (Telecom Italia Capital S.A.).  | 6   |
| Currency Forward transactions (Telecom Italia Sparkle S.p.A.) | 43  |
| Currency Forward transactions (Olivetti S.p.A.)               | 6   |
| <b>Total</b>  | <b>372</b>                                |

The market value of derivatives on financial assets and short-term treasury operations as of December 31, 2006 was a net loss of approximately 6 million compared to a net loss of 11 million as of December 31, 2005. The market value of short-term treasury operations has been measured by discounting at December 31, 2006, for each transaction, the product between (i) the amount purchased/sold and (ii) the difference between the contractual exchange rate and the forward exchange rate as of December 31, 2006 having the same maturity date.

For a further discussion of derivative instruments on financial assets and on short-term treasury operations see Note 4, Financial Risk Management, of our Notes to our Consolidated Financial Statements included elsewhere in this Annual Report.



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

The shareholders' meeting held on May 6, 2004 established that the Board of Directors of Telecom Italia S.p.A. be composed of 19 members and appointed the Board of Directors of Telecom Italia S.p.A. for the three years ending upon the approval of the financial statements for the year ended December 31, 2006. The shareholders' meeting held on April 7, 2005 then revised the number of members of the Board of Directors to 21 and appointed Marco De Benedetti and Enzo Grilli as directors to complement the original Board.

The shareholders' meeting held on April 13, 2006 appointed Diana Bracco and Vittorio Merloni as directors following the resignations of Marco De Benedetti and Giovanni Consorte.

On September 15, 2006, Marco Tronchetti Provera submitted his resignation as Chairman and director of the Board. On the same day, the Board of Directors appointed Guido Rossi as Chairman while Carlo Orazio Buora (then CEO) was appointed Executive Deputy Chairman and the post of CEO held by Riccardo Ruggiero remained unchanged.

In October 2006, Enzo Grilli passed away and on April 6, 2007 Guido Rossi resigned as Chairman of the Board of Directors and as a director, without the Board of Directors appointing new directors to replace them.

The shareholders' meeting held on April 16, 2007 established that the Board of Directors of Telecom Italia S.p.A. be composed of 19 members and appointed the Board of Directors of Telecom Italia S.p.A. for a one year period ending upon the approval of the financial statements for the year ended December 31, 2007.

On April 17, 2007, the Board of Directors of Telecom Italia S.p.A. appointed Pasquale Pistorio as Chairman and confirmed Carlo Orazio Buora as Executive Deputy Chairman and Riccardo Ruggiero as Chief Executive Officer.

The following are the members of the Board of Directors of Telecom Italia as of June 13, 2007.

| <u>Name</u>        | <u>Age</u> | <u>Position</u>           | <u>Appointed</u> |
|--------------------|------------|---------------------------|------------------|
| Pasquale Pistorio  | 71         | Chairman                  | 2004             |
| Carlo Orazio Buora | 61         | Executive Deputy Chairman | 2003             |
| Riccardo Ruggiero  | 46         | Chief Executive Officer   | 2003             |

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|                             |    |          |      |
|-----------------------------|----|----------|------|
| Paolo Baratta(1)            | 67 | Director | 2004 |
| Gilberto Benetton           | 65 | Director | 2003 |
| Diana Bracco(1)             | 65 | Director | 2006 |
| Stefano Cao(1)              | 55 | Director | 2007 |
| Renzo Capra(1)              | 77 | Director | 2007 |
| Claudio De Conto            | 44 | Director | 2007 |
| Domenico De Sole(1)         | 63 | Director | 2004 |
| Luigi Fausti(1)             | 78 | Director | 2003 |
| Jean Paul Fitoussi(1)       | 64 | Director | 2004 |
| Luciano Gobbi               | 54 | Director | 2007 |
| Aldo Minucci                | 60 | Director | 2007 |
| Gianni Mion                 | 63 | Director | 2003 |
| Renato Pagliaro             | 50 | Director | 2004 |
| Carlo Alessandro Puri Negri | 54 | Director | 2003 |
| Cesare Giovanni Vecchio(1)  | 45 | Director | 2007 |
| Luigi Zingales(1)           | 44 | Director | 2007 |

(1) Independent Directors. For details on the criteria applied to determine independence, see Item 10. Additional Information 10.1 Corporate Governance 10.1.2 General Board of Directors Independent Directors .

As of June 13, 2007, the Secretary of the Board of Directors was the General Counsel of Telecom Italia, Francesco Umile Chiappetta.

In 2006:

- the Board of Directors met eight times, with such meetings generally scheduled pursuant to a timetable set forth in advance;

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- the Internal Control and Corporate Governance Committee (Guido Ferrarini Chairman, Francesco Denozza, Domenico De Sole and Marco Onado) held 15 meetings. The Committee meetings are normally attended by the Chairman of the Board of Auditors or by another auditor it designates; where deemed desirable in light of the issues on the agenda, the Committee and the Board of Auditors have held joint meetings;
- the Remuneration Committee (Luigi Fausti Chairman, Pasquale Pistorio and Paolo Baratta) met 5 times;
- the Strategy Committee (the Chairman of the Board, the Executive Deputy Chairman Carlo Orazio Buora, and Directors Domenico De Sole, Marco Onado and Pasquale Pistorio) met 3 times.

In 2006 the Chairman of the Internal Control and Corporate Governance Committee (Guido Ferrarini) acted as Lead Independent Director.

For a detailed description of Telecom Italia's corporate governance, including activities, responsibilities and organization of the Board of Directors and the Committees, see Item 10. Additional Information 10.1 Corporate Governance .

**6.1.1 BIOGRAPHICAL DATA**

The following are the selected biographical data of the Directors.

**Pasquale Pistorio:** Pasquale Pistorio was born in Agira (Enna), in 1936. Mr. Pistorio has been a Director of Telecom Italia since May 6, 2004. He was appointed Chairman of Telecom Italia S.p.A. on April 17, 2007. Pasquale Pistorio spent the first 17 years of his career at Motorola before taking the helm of Italy's SGS Microelettronica in 1980. In May 1987, SGS and France's Thomson Semiconducteurs merged to create SGS-THOMSON Microelectronics, now ST Microelectronics N.V.. Under Pasquale Pistorio's guidance, ST Microelectronics established itself as a broad range manufacturer and rose through the world semiconductor ranks from number 15 in 1987 to one of the top five companies in the industry. In the last 25 years, Pasquale Pistorio has championed the cause of Europe's microelectronics industry and has been on the Board of MEDEA+ and Chairman of the European Union's Technology Platform (ENIAC). He has also been a firm advocate of corporate social responsibility, especially in the environmental field, for ethical and social reasons, as well as his conviction that environmentally friendly companies are more competitive. He has been a member of the United Nations Task Force dedicated to bridging the Digital Divide. Since May 2004 Pasquale Pistorio was called to take the position of Deputy Chairman for Research and Innovation of Confindustria, the Confederation of Italian Industrialists and in this role he is a staunch advocate of research as a top priority for the political agenda of the country. He is also a Director of the Boards of Fiat Group and Chartered Semiconductors (Singapore). Throughout his career Pasquale Pistorio has received numerous awards and honors for his achievements. Upon his retirement as President and CEO of ST Microelectronics N.V. on March 18, 2005, Pistorio was appointed Honorary Chairman of the Company.

**Carlo Orazio Buora:** Carlo Orazio Buora was born in Milan, in 1946. Mr. Buora has been Executive Deputy Chairman of Telecom Italia S.p.A. since September 15, 2006 and from November 2001 to April 2007 Managing Director. He began working in finance with the BNL group. Afterwards he became head of Finance and Administration at Merloni Finanziaria and Chief Financial Officer at Snia Viscosa. In 1984 he joined the Fiat group. In 1989 he was appointed Deputy General Manager of Telettra and

subsequently General Manager of the Benetton group, a position he held until 1991. In November 1991 he joined the Pirelli group as central manager for finance and administration and was appointed General Manager in 1992. In 1999 he became a general partner of Pirelli & C. S.a.p.a. and in 2001 was appointed Managing Director of Pirelli & C. S.p.A. Upon his appointment as Executive Deputy Chairman at Telecom Italia, in November 2006, Mr. Buora relinquished all of his positions in the Pirelli group. Mr. Buora is also a Director of Mediobanca S.p.A. and is a Board member of the European Oncology Institute. Since January 2004, he has been Deputy Chairman of F.C. Internazionale S.p.A..

**Riccardo Ruggiero:** Riccardo Ruggiero was born in Naples, in 1960. Since October 1, 2001 Mr. Ruggiero has been Head of the Telecom Italia Group Wireline Business Unit. On May 7, 2002 he was appointed General Manager of Telecom Italia and on September 5, 2002 he was appointed Chief Executive Officer. He began his career in 1986 as sales manager of Fininvest S.p.A.. Between 1988 and 1990 he was sales and marketing manager of the Italian branch of AT&T. In 1990 he joined the Olivetti group, where he held various positions: in 1992 he was appointed Vice President of Organizzazione Oliservice, with responsibility for international clients and the

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commercial development of telecommunications services worldwide, and in 1994 of Olivetti Telemedia, with responsibility for commercial development and market expansion. In 1996 he was appointed Managing Director of Infostrada S.p.A. (with responsibility for the market, infrastructure and personnel functions) and was later appointed Managing Director of Italia On Line. In July 2001, Mr. Ruggiero joined the Telecom Italia Group as Head of the Telecom France Business Unit, responsible for managing and developing Telecom Italia Group's business on the French market. Mr. Ruggiero has been Director of Safilo group S.p.A. since October 24, 2005.

**Paolo Baratta:** Paolo Baratta was born in Milan in 1939. Mr. Baratta has been a Director of Telecom Italia since May 6, 2004. In 1967 he began doing economic research at the Associazione per lo sviluppo dell'industria nel Mezzogiorno (Svimez) in Rome. In 1979 he became a Director of the Istituto per il Credito alle Imprese di Pubblica Utilità (ICIPU) and then Deputy Chairman. From 1980 to 1992 he was Chairman of ICIPU, Consorzio di Credito per le Opere Pubbliche (CREDIOP), Deputy Chairman of Nuovo Banco Ambrosiano (later Banco Ambrosiano Veneto) and the Italian Bankers' Association (ABI). In addition to being a Director of various companies, he was Chairman of the Centro Beneduce per gli Studi in Campo Bancario e Assicurativo. In 1993 he became Minister for Privatizations with responsibility for the reorganization of the system of state holdings. In 1993-94 he was Minister for Foreign Trade and Minister for Industry ad interim. In 1995-96 he was Minister for Public Works and Minister for the Environment. From 1997 to 2000 he was chairman of Bankers' Trust S.p.A. and from 1998 to 2000 Chairman of the Biennale di Venezia. He is a member of the Società Italiana degli Economisti and currently is Chairman of the Comitato Venezia Internazionale, the Centro per la Proprietà Intellettuale di Venezia and the Fondazione Lorenzo Valla. He is also a Director of Edizione Holding S.p.A., Svimez-Roma, the Fondo per l'Ambiente Italiano (FAI).

**Gilberto Benetton:** Gilberto Benetton was born in Treviso, in 1941. Mr. Benetton has been a Director of Telecom Italia since September 27, 2001. He began his activity in 1965 with his siblings Giuliana, Luciano and Carlo. The Benetton group is active in 120 countries. Mr. Benetton is also Deputy Chairman of Olimpia S.p.A, Chairman of Edizione Holding S.p.A. and Sintonia S.p.A., Autogrill S.p.A., Ragione S.a.p.a., Verde Sport S.p.A., Deputy Chairman of Fondazione Benetton, Director of Benetton group S.p.A., Pirelli & C. S.p.A., Mediobanca S.p.A., Schemaventotto S.p.A., Lloyd Adriatico S.p.A., Autostrade S.p.A. and Aldeasa S.A..

**Diana Bracco:** Diana Bracco was born in Milan, in 1941. Mrs. Bracco has been a Director of Telecom Italia since April 13, 2006. Graduated with a Degree in Chemistry from the University of Pavia where, in 2001, she was awarded an Honorary Degree in Pharmaceutical Science. Mrs. Bracco is currently Chairman and Managing Director of Bracco S.p.A.; Managing Director of Centro Diagnostico Italiano S.p.A.; Director of Humanitas S.p.A., CNR (National Research Council) and Assonime (Association for Italy's Limited Liability Companies). She is also President of Assolombarda (Association of Firms in the Province of Milan), member of the General Council of Confindustria (Confederation of Italian Industry), member of the President's Committee and past President of Federchimica (Italian Federation of the Chemical Industry), and Confindustria's Mai Foundation for Research. She was awarded the honorific title of Cavaliere del Lavoro in 2002; has an honorary degree in medicine from the Università Cattolica del Sacro Cuore in Rome.

**Stefano Cao:** Stefano Cao was born in Rome, in 1951. Mr. Cao has been a Director of Telecom Italia since April 16, 2007. He graduated in Mechanical Engineering. Employed by the Eni group on December 1, 1976. Manager of the Eni group since October 1, 1983. Employed by Saipem in 1976, working until 1982 in the Sea Platforms business as Field Engineer and Site Manager. Involved in various overseas postings from 1982 to 1986: Project Manager in England, Branch Manager in Denmark, Operation Manager for offshore activities in the North Sea. Recalled to headquarters in 1986 to coordinate the Engineering activities and in 1988 was appointed Deputy General Manager Sea Platforms Business, a position held until 1993 when he assumed the position of General Manager Marketing and Technical Activities. After nomination as Managing Director Operations in 1996 and having taken on, in 1998, the position of Managing Director Production and Marketing, in 1999 he has been appointed for the Chairmanship of Saipem. In 2000 he has been appointed General Manager of Eni S.p.A. Exploration and Production Division. From 2001 to 2003 he was President of Agip International B.V. and of Agip Exploration B.V., a sub holding of the overseas sector

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of the Exploration and Production Division. From May 2002 to 2006 he was President of Assomineraria (Italian Association for the Mining and Petroleum Industries). From May 2004 to 2006 he was President of Eni Corporate University.

**Renzo Capra:** Renzo Capra was born in Ponte dell' Olio (Piacenza), in 1929. Mr. Capra has been a Director of Telecom Italia since April 16, 2007. He graduated in Electro Technical Industrial Engineering at Milan Polytechnic, and from 1956 until the end of 1964 he worked at ANIC S.p.A., and on the SNAM PROGETTI in the plants of Ravenna and Gela. In 1965 he was employed by the Azienda Servizi Municipalizzati of Brescia (Brescia Municipal

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Utilities) as Energy Services Director; from 1979 until 1995 he was the General Manager; in 1995 he became President of ASM Brescia, which became a Public Limited Company in July 1998 and which was listed on the Milan Stock Exchange in July 2002. From 1968 until 1973 he collaborated in the Electrical Power Station teaching course at Milan Polytechnic; in 1973 he moved to the University of Brescia. From December 2002 until December 2006 he was President of the Istituto di Economia delle Fonti di Energia (IEFE) at Milan's Bocconi University. He is a member of the FederUtility Presidential Committee, Vice-President of CISPEL Lombardy, and Chairman of the FEDERAMBIENTE Board of Auditors. Since July 2006 he has represented Italy as President of CEDEC (Business Confederation of local European electricity and gas distributors), whose headquarters are in Brussels.

**Claudio De Conto:** Claudio De Conto was born in Milan, in 1962. Mr. De Conto has been a Director of Telecom Italia since April 16, 2007. He graduated in Business Economics in 1986 at the Luigi Bocconi Commercial University of Milan. After graduation he joined Ernst & Whinney in England. In 1988 he joined the Pirelli group. After 5 years working in the group's Treasury Office, in 1993 he undertook a long international experience in the areas of Administration, Finance and Control of the group subsidiaries in the Tyres Sector in Brazil, Spain and Germany. In particular, between 1996 and 2000 he was employed as CFO of Pirelli Neumaticos S.A. (Spain) and subsequently CFO of Pirelli Deutschland A.G. (Germany). In 2000 he became Manager of Administration, Planning and Control of Pirelli S.p.A. In 2001 he was appointed General Manager Administration and Control of Pirelli S.p.A., a position he maintained in the Parent Company Pirelli & C. S.p.A. after the merger with Pirelli S.p.A. in August 2003. From November 2006 he is General Manager of Operations of Pirelli & C. S.p.A. Within the Pirelli group, his responsibilities are: Chairman of the Board of Directors of Pirelli Broadband Solutions S.p.A. and of Centro Servizi Amministrativi Pirelli S.r.l.; Director of Pirelli Tyre S.p.A., Pirelli & C. Real Estate S.p.A., Pirelli & C. Ambiente S.p.A., Pirelli Labs S.p.A., Pirelli Servizi Finanziari S.p.A. and Pirelli International Limited. He is also a member of the Supervisory Board of Pirelli Deutschland GmbH. He is also a Director of Rcs MediaGroup S.p.A., Emittenti Titoli S.p.A. and Efibanca Palladio Finanziaria SGR. Since 2002 he has been a member of the International Financial Reporting Interpretation Committee (IFRIC) institute within the International Accounting Standards Board (IASB).

**Domenico De Sole:** Domenico De Sole was born in Rome in 1944. Mr. De Sole has been a Director of Telecom Italia since May 6, 2004. In 1970 he moved to the United States, where he became a partner with the law firm of Patton, Boggs & Blow. In 1984 he joined the Gucci group as Managing Director of Gucci America Inc. and in 1995 he became Managing Director for the entire Gucci group as President and Managing Director of Gucci group N.V. until April 2004. During this period Gucci group was listed on the New York and Amsterdam stock exchanges (1995), beat off a hostile takeover bid (1999), acquired Yves Saint Laurent, Sanofi Beaut e and Sergio Rossi in 1999, Boucheron, Alexander McQueen and Bedat & Co in 2000 and Bottega Veneta, Stella McCartney and Balenciaga in 2001. Mr. De Sole is a Director of Delta Airlines (member of Finance and Governance Committees), of Bausch & Lomb (member of the Audit Committee), Gap Inc. (member of the Audit Committee) and Ermenegildo Zegna S.p.A.. He is a member of the Advisory Board of the Harvard Law School.

**Luigi Fausti:** Luigi Fausti was born in Ancona, in 1929. Mr. Fausti has been a Director of Telecom Italia since November 7, 2001. He is also Director of Monrif S.p.A., of Poligrafici Editoriale S.p.A. di Bologna, of Mediaset S.p.A. and Chairman of Patrimonio Immobiliare dello Stato S.p.A.. Mr. Fausti began his career in 1947 in Banca Commerciale Italiana where he was Executive Officer and General Director of several branches and subsequently became Managing Director of the bank in 1990, Vice-Chairman and Managing Director in 1994, Chairman in 1997 and Honorary Chairman in 1999. He received an *honoris causa* economics degree from Naples University.

**Jean Paul Fitoussi:** Jean-Paul Fitoussi was born in La Goulette (Tunisia) in 1942. Mr. Fitoussi has been a Director of Telecom Italia since May 6, 2004. Mr. Fitoussi is Professor of Economics at the Institut d'  tudes Politiques in Paris, where he has taught since 1982 and whose Scientific Committee he now chairs. He is currently President of the Observatoire Franais des Conjonctures Economiques (OFCE), an economic research and forecasting institute. Mr. Fitoussi graduated cum laude in Law and Economics from the University of Strasbourg with a thesis on inflation, equilibrium and unemployment. He began his academic career as an

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assistant professor at the University of Strasbourg. Between 1979 and 1983 he taught at the European University Institute, Florence, and in 1984 was visiting professor at the University of California, Los Angeles. Since 1998 he has been a member of the board of the École Normale Supérieure. In 1997 he became a member of the Prime Minister's Council for Economic Analysis. In 1996 he was named to the Commission Économique de la Nation. He was secretary of the International Economic Association beginning in 1984 and has been an expert for the Economic and Monetary Committee of the European Parliament. Between 1990 and 1993 he was Chairman of the Economic Council of the



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European Bank for Reconstruction and Development. In the field of publishing, Mr. Fitoussi is managing editor of the Revue et Lettre de L'OFCE and serves on the scientific committee of the Revue Française d'Économie, the editorial board of Labour and The International Journal of Development Planning Literature, and the scientific committee of International Labour Review and Critique Internationale. His writing appears regularly in newspapers in France and abroad and he is commentator for La Repubblica and Le Monde. Since 2002 he has been Director of the Fondation Nationale des Sciences Politiques. In the field of research, Mr. Fitoussi has concentrated on inflation theory, unemployment, foreign trade and the role of macroeconomic policy. As president of the OFCE and founder of its International Economic Policy Group (of which he is a member), he has made numerous contributions to the current economic policy debate, particularly on the issues of economic integration and transition.

**Luciano Gobbi:** Luciano Gobbi was born in Piacenza, in 1953. Mr. Gobbi has been a Director of Telecom Italia since April 16, 2007. He graduated in Nuclear Engineering in 1977 at the Milan Polytechnic. In 1978 he took a Masters in Business Administration at the Luigi Bocconi Commercial University of Milan. He graduated in Architecture in 1983 at the Milan Polytechnic. In 1978 he joined The Chase Manhattan Bank, where he worked as a Credit Analyst and subsequently as Senior Banker in London, Milan and Rome. In 1986 he joined the Pirelli group as Corporate Finance Director. In 2000 he became General Manager Finance, a position he maintained in the parent company Pirelli & C. S.p.A. after the merger with Pirelli S.p.A. in August 2003. Since November 2006 he has been General Manager Finance and Strategic Planning for Pirelli & C. S.p.A.. Within the Pirelli group he also holds the position of Director of Pirelli Tyre S.p.A. and Pirelli Labs S.p.A.. He has been a Director of Olimpia S.p.A. since 2001.

**Aldo Minucci:** Aldo Minucci was born in Reggio Calabria, in 1946. Mr. Minucci has been a Director of Telecom Italia since April 16, 2007. After graduating in Law, in 1972 he was employed by Assicurazioni Generali S.p.A., working in the Fiscal Advice Service, for which he became Manager in 1983. In 1993 he was appointed Central Executive Officer with responsibility for the Administration and Financial Coordination Service, and supervision of the Fiscal Advice Service. In 1995 he took on the role of Vice Chief Executive Officer Technical-Commercial Coordination for the Insurance Companies in Italy, and is Supervisor of the Group Internal Audit Service. Mr. Minucci is Director of Alleanza Assicurazione S.p.A., Director of the Banca Generali S.p.A., Chairman of GENERTEL S.p.A., Director of AC.E.GA.S. S.p.A., Chairman of SIMGENIA S.p.A., Director of Generali Servizi Amministrativi S.p.A., Director of Intesa Previdenza SIM S.p.A., Director of Intesa Vita S.p.A., Director of La Venezia Assicurazioni S.p.A., Director of Gemina S.p.A., Director of Toro S.p.A., Deputy Chairman of Nuova Tirrena S.p.A., Director of INA Assitalia S.p.A., Director of FATA Vita S.p.A. and Director of FATA Assicurazioni Danni S.p.A..

**Gianni Mion:** Gianni Mion was born in Vó (Padova), in 1943. Mr. Mion has been a Director of Telecom Italia since November 7, 2001. He is currently Managing Director of Edizione Holding S.p.A. (holding company of the Benetton family) and Sintonia S.p.A. (appointed in March 2007). He is also Director of Benetton group S.p.A., Autogrill S.p.A., ADR Aeroporti di Roma S.p.A., 21-Investimenti, Autostrade S.p.A., Cartiere Burgo S.p.A., Luxottica group S.p.A., Olimpia S.p.A. and Fondazione Cassa di Risparmio di Venezia. Mr. Mion is a Registered Auditor.

**Renato Pagliaro:** Renato Pagliaro was born in Milan in 1957. Mr. Pagliaro has been a Director of Telecom Italia since May 6, 2004. A registered auditor, he joined Mediobanca Banca di Credito Finanziario S.p.A. in 1981, where he has held positions of increasing responsibility. In April 2003 he was appointed Co-General Manager and Secretary to the Board of Directors of Mediobanca S.p.A.. Mr. Pagliaro is a Director and member of the Executive Committee of RCS Mediagroup S.p.A., Compass S.p.A. and Cartiere Burgo S.p.A.. He is also a Director of SelmaBipiemme Leasing S.p.A. and Cofactor S.p.A.. Since 1993 he has been a member of the Board of Auditors of Istituto Europeo di Oncologia S.r.l..

**Carlo Alessandro Puri Negri:** Carlo Alessandro Puri Negri was born in Genoa, in 1952. Mr. Puri Negri has been a Director of Telecom Italia since November 7, 2001. Mr. Puri Negri is also Director of Aon Italia S.p.A., Olimpia S.p.A. and Pirelli Tyre S.p.A..

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He is Deputy Chairman and Managing Director of Pirelli & C. Real Estate S.p.A., Deputy Chairman of Camfin S.p.A. and Pirelli & C. S.p.A.. He is Chairman of Pirelli & C. Ambiente S.p.A.. Since 2003 Mr. Puri Negri has been a Director of Istituto Europeo di Oncologia S.r.l. and a member of Real Estate Int. Advisory Board of Harvard University. Since 2004 Mr. Puri Negri is also Director of Fondazione Cerba and Assoimmobiliare (real estate industrial association in Italy).

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**Cesare Giovanni Vecchio:** Cesare Giovanni Vecchio was born in Pavia, in 1962. Mr. Vecchio has been a Director of Telecom Italia since April 16, 2007. Lawyer and official accounts auditor. Mr. Vecchio graduated with Prof. Giulio Tremonti, he was an associate of his firm for nearly ten years. In 1977, after having practiced as lawyer also with Studio Chiomenti in Milan, he has been a partner of Freshfields Bruckhaus Deringer, which he recently left to take on a partnership at Delfino & Associati Willkie Farr & Gallagher. Author of numerous fiscal and financial publications (some published by Sole 24 Ore ), he is considered a specialist in structured finance and company acquisitions, assisting leading Italian and international banks and financial institutions. He currently holds the Chairmanship of the Board of Directors of Fingruppo Holding S.p.A. and he is Director of Sorin S.p.A..

**Luigi Zingales:** Luigi Zingales was born in Padova, in 1963. Mr. Zingales has been a Director of Telecom Italia since April 16, 2007. Luigi Zingales is the Robert C. McCormack Professor of Entrepreneurship and Finance at the Graduate School of Business of the University of Chicago, where he has been a member of the faculty since 1992. Last academic year he held the prestigious Taussig Research Professorship at Harvard University. He is a faculty research fellow of the NBER, a research fellow of the Centre for Economic Policy Research (CEPR), a director of the American Finance Association, a member of the Committee on Capital Market Regulation, and of the United Nation Advisory Board on Microfinance. In 2003 he won the Bernacer Prize for the best European young financial economist. His research interests span from corporate governance to financial development, from political economy to the economic effects of culture. He has published extensively in the major economics and financial journals. He is an editorialist for Il Sole 24 ore (the leading Italian economic newspaper).

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As of June 13, 2007, the executive officers of Telecom Italia and their respective ages, positions and year of appointment as executive officers were as follows:

| <b>Name</b>             | <b>Age</b> | <b>Position</b>  | <b>Appointed</b> |
|-------------------------|------------|--|------------------|
| <b>Directors:</b>       |            |  |                  |
| Pasquale Pistorio       | 71         | Chairman   | 2007             |
| Carlo Orazio Buora      | 61         | Executive Deputy Chairman  | 2001             |
| Riccardo Ruggiero       | 46         | Chief Executive Officer<br>General Manager of Telecom Italia   | 2002<br>2002     |
| <b>Managers:</b>        |            |  |                  |
| Paolo Annunziato        | 46         | Head of Public Affairs Function  | 2007             |
| Filippo Bettini         | 46         | Head of Strategy Function  | 2007             |
| Gustavo Bracco          | 59         | Head of Human Resources Organization and<br>Security Function  | 2006             |
| Antonio Campo Dall Orto | 43         | Chief Executive  |                  |
| Massimo Castelli        | 47         | Officer of Telecom Italia Media<br>General Manager of Telecom Italia                                   | 2007             |
| Francesco Chiappetta    | 46         | Head of Domestic Fixed Services Department<br>General Counsel  | 2006             |
| Luca Luciani            | 39         | Head of General Counsel & Corporate and<br>Legal Affairs Function<br>General Manager of Telecom Italia | 2006             |
| Enrico Parazzini        | 63         | Head of Domestic Mobile Services Department<br>General Manager of Telecom Italia                       | 2006             |
|                         |            | Head of Finance, Administration and Control<br>Function  |                  |
| Stefano Pileri          | 51         | Chairman of Telecom Italia Media<br>General Manager of Telecom Italia                                  | 2006             |
| Germanio Spreafico      | 54         | Head of Technology Department  | 2006             |
| Gianpaolo Zambetti      | 66         | Head of Purchasing Function<br>Head of International Affairs Function                                  | 2006<br>2006     |

The following are the selected biographical data of the executive officers, other than Directors:

For the biographical data of Mr. Pasquale Pistorio, Mr. Buora and Mr. Ruggiero, please see above under 6.1 Directors .

**Paolo Annunziato:** Mr. Annunziato was born in Rome in 1961. On May 25, 2007, he became Head of Public Affairs Department. Mr. Annunziato began his career at the World Bank and International Monetary Fund in Washington. In 1989, he moved to consulting firm A. T. Kearney in Chicago. He joined Confindustria in 1990, moving to Rome, where until 1997 he ran the Real Economy unit at the organization's research center. At Confindustria, he became Head of the Young Entrepreneurs unit, to which, in 2001, he added a role as Manager of Research, Innovation and the Net Economy.

**Filippo Bettini:** Mr. Bettini was born in Brescia, in 1960. On January, 22 2007 he became Head of Strategy, Telecom Italia Group. He began his career in 1985 at Hoffmann la Roche. Over the following six years he held various positions in research & development and marketing; in 1989 he was appointed Marketing Director of the Italian subsidiary. From 1991 to 1993 he worked at Amplifon Group, as Marketing and Sales Manager. From 1994 to 2000 he managed companies focused in biomedical and biotechnological sector with a strong commitment in research & development and innovation, among which the San Raffaele Biomedical Science Park and Molmed, a molecular medicine research company. From 2001 to 2002 he took the responsibility of Pirelli Labs, the Pirelli group research & development company focused on optical and material innovation. In 2002 he joined Telecom Italia as responsible of the Operations of Telecom Italia Lab, the group company focused on research & development and venture capital activities. From 2004 to 2006 he covered the position of Executive Assistant to the Chairman of Telecom Italia.

**Table of Contents****Item 6. Directors, Senior Management and Employees****Executive Officers**

**Gustavo Emanuele Bracco:** Mr. Bracco was born in Turin, in 1948. On October 1, 2001, he became Head of Telecom Italia Group Human Resources. Mr. Bracco began his career at Fiat in 1972, working for the Trade Union Relations Central Management. In 1976, he was appointed Personnel Manager at the Mirafiori factory. In 1977, he transferred to Toro Assicurazioni as Head of Industrial Relations and Labour Disputes, under the aegis of Central Personnel Management. He joined the Turin Industrial Union in 1979, where he worked until 1982, initially at the Research Office before moving to the Trade Union Service, where he rose through the ranks to the position of Head. Between 1983 and 1987, he worked at Cinzano, Saiag and Carello, with responsibility for Personnel and External Relations. In 1988, he returned to the Fiat Group as Head of Personnel and Organization at the Engine Control Division. He took on the same role at CEAC in 1991 and at Fidis in 1994. He was appointed Head of Group Trade Union Relations in 1996. In 1998, Mr. Bracco went to work in London for New Holland as Head of Personnel and Organization, a position he subsequently filled in Chicago for Case-New Holland. He joined Pirelli in December 2000 as Group Head of Human Resources. Mr. Bracco is Director of Telecom Italia Audit and Compliance Services S.c.a.r.l..

**Antonio Campo Dall Orto:** Mr. Campo Dall Orto was born in Conegliano in 1964. He was appointed General Manager, Television, of Telecom Italia Media in 2005. Mr. Campo Dall Orto received a degree in Economics from Ca' Foscari University in Venice in 1988 and a Master in Marketing and Corporate Communication from Publitalia, Milan in 1992. He started his career in 1989 where he was working for IMS Europe as Head of Industry Analysis until 1991. In 1992 he joined Plasmon, working in product marketing, where he was responsible for competitive analysis and actions from repositioning Plasmon brands in the market for dietetic and therapeutic foods. In the same year he started working for Mediaset in Milan as Deputy Director of Canale 5 where he held this position until 1996. From 1992 to 1996 Mr. Campo Dall Orto was appointed Professor at the Communication s Academy in Milan where he taught Competitive Analysis and Marketing. From 1997 to 1999, he worked as General Manager of MTV Italia and in 1999 was promoted to Managing Director for MTV Southern Europe (Italy, France, Spain, Portugal, Greece) for MTV Europe. In 2001 Mr. Dall Orto joined Telecom Italia Media as Managing Director of MTV Italia and MTV Pubblicità and as program and contents manager of TV channel La7 and in 2005 he was appointed the General Manager Television with responsibility for the television business, based on both analogical and digital terrestrial technology, overseeing selection and purchase of contents, management and optimization of production processes as well as commercial development. Since February 2007 Mr. Campo Dall Orto is member of the Board of Directors and Chief Executive Officer of Telecom Italia Media.

**Massimo Castelli:** Mr. Castelli was born in Rome, in 1959. On February 16, 2007, Mr Castelli was appointed General Manager of Telecom Italia (Domestic Fixed Services). Mr. Castelli began his career in 1985 in Olivetti S.p.A., Commercial Division Italia, Marketing. In 1996 Mr. Castelli was appointed Vice President Marketing in Infostrada. Mr. Castelli began his career in the Telecom Italia Group on October 10, 2001, when he was appointed Vice President Marketing of Wireline; in 2004 he became Executive Vice President Marketing & Sales of TIM and, on April 15, 2005, Chief Operating Officer of Tim Italia. On October 5, 2005, Mr. Castelli became Chief Marketing Officer of Telecom Italia.

**Francesco Chiappetta:** Mr. Chiappetta was born in Rome, in 1960. Mr. Chiappetta was appointed Telecom Italia General Counsel on August 1, 2002 and Head of Corporate and Legal Affairs on November 25, 2005. He is also the Secretary to the Telecom Italia Board of Directors. On January 22, 2007, he became Head of Group Function General Counsel & Corporate and Legal Affairs .

Mr. Chiappetta began his career in 1983 at CONSOB, Italy s stock market and corporate regulatory body. Over the next ten years he held a number of positions at this organization, including Chief of the Regulation Office. Between 1998 and July 2001 he worked as Deputy General Manager for Assonime, the Association of Italian Corporations, with responsibility for company law and capital markets. In August 2001 he joined the Pirelli & C. Group as Head of Legal and Corporate Affairs, a position he filled until joining the Telecom Italia Group. From 1989 to 2006 he worked in academia, holding courses and lectures at leading Italian universities including La Sapienza in Rome, Università di Roma Tre and the Luigi Bocconi University in Milan. Mr. Chiappetta has widely published both on company and securities law. At the present time he his also Chairman of the Company Law Working Group of Unice (Union of Industrial and Employers Confederation of Europe). Since April 2005, Mr. Chiappetta is a member of the Advisory Group on Company Law and Corporate Governance, a group of experts established by the European Commission.



**Table of Contents****Item 6. Directors, Senior Management and Employees****Executive Officers**

**Luca Luciani:** Mr. Luciani was born in Padova, in 1967. On February 16, 2007 he was appointed General Manager of Telecom Italia (Domestic Mobile Services). Mr. Luciani began his career in Procter & Gamble in 1990; in 1994, he became Consulting Manager of Bain & Company Consulting and in 1998 Group Controller of Enel Group. He joined the Telecom Italia Group in 1999 as Group Controller; in 2002 he was appointed Chief Financial Officer of TIM and, in 2003, he was appointed Executive Assistant to the Chairman of Telecom Italia. In 2004 he became Responsible for Marketing activities of TIM and from 2004 he was Responsible for IT and Network Services and coordination of International activities. In 2005, he was appointed Chief Marketing Officer of TIM. On October 5, 2005, Mr. Luciani became Responsible for the Indirect Sales channels of the Group.

**Enrico Parazzini:** Mr. Parazzini was born in Milan, in 1944. On February 16, 2007 he was appointed General Manager of Telecom Italia S.p.A. (Finance Administration and Control). Since February 7, 2007 he has been Chairman of Telecom Italia Media, maintaining also his position as Chief Financial Officer of the Telecom Italia Group. Since October 1, 2001 he has been CFO of the Telecom Italia Group. After graduating in Economy and Commerce at Luigi Bocconi University, he commenced his professional career in 1968 as Junior Auditor at Arthur Andersen and in 1969 changed to General Electric, where he worked in the Finance Department. In 1970 he passed to Honeywell Information Systems Italia, a company where in the course of the next twenty years he held positions of growing responsibility: Financial Planning Director from 1975 to 1980; Director of Administration and Control from 1981 to 1986 and Chief Financial Officer from 1987 to 1990. A year later, following the disposal of Honeywell's activities to Bull, Mr. Parazzini was appointed General Manager of Administration, Control, Information Technology Systems and Logistics. In May 1992 he joined Pirelli as Director of Planning and Control (Group Controller), and participated to the turnaround of the Group and, more particularly, to the reorganization of the planning and control system. Between 1996 and 1999 he was in charge of Planning and Control, Administration, Group Purchases and Risk Management. In 2000 he was appointed Chief Financial Officer of Pirelli's Cable and Systems Sector. From 1994 to 2000 he was visiting lecturer at the Luigi Bocconi University for the course on Planning and Control in Multinational Groups; since 2002 he has been acting as Professor for the Master in Corporate Finance at the Luigi Bocconi University's Management School (Scuola di Direzione Aziendale SDA).

**Stefano Pileri:** Mr. Pileri was born in Rome, in 1955. On February 16, 2007 he was appointed General Manager of Telecom Italia (Technology). He has been in SIP (Italian Telecom Operator) since 1982 where he assumed growing responsibilities, during the years, in the Network Management Systems Department. From 1993 to 1994 he was responsible for the Network Development and Operations in the Emilia-Romagna region, and in 1997 he became Responsible for Network Planning, Engineering and Marketing in the Network Division of Telecom Italia. In March 1998 he became Responsible of the Telecom Italia Wireline Network and in June 2005 he was also appointed Chief Technology Officer of the Telecom Italia Group, directly reporting the Chairman, with the responsibility to drive and coordinate the fixed-mobile integration and the overall technological network development. Mr. Pileri is Director of Italtel.

**Germanio Spreafico:** Mr. Spreafico was born in Lecco, in 1952. He was appointed Head of Telecom Italia Group Purchasing on October 1, 2001. He began his career in 1977 at the Pirelli Financial Division, where he worked for 10 years, during which time he was promoted through various positions in domestic and international finance and ultimately took charge of Italian market financial operations. Subsequent to this he moved to the Cable sector, initially as Chief Financial Officer of the Italian operations, before taking on the same role in the French subsidiary. In 1997, he became Chief Financial Officer and board member of the Group Cable Industry Holding Company, where he also took on the position of Chief Purchasing Officer. At the present time, Mr. Spreafico is Chairman of Telenergia S.r.l. and Olivetti Multiservices S.p.A..

**Giampaolo Zambelletti:** Mr. Zambelletti was born in Varese, in 1941. He was appointed Head of Telecom Italia Group International Affairs on June, 2003. He began his career in 1966 in Madrid, starting the activities of Zambelletti Espana S.A., where he remained Chief Executive Officer until 1980. In the early eighties he was appointed Chairman and Chief Executive Officer in Zambelletti S.p.A. parent company in Italy, which was sold then to the English Beecham plc in 1984. Giampaolo Zambelletti remained in the company as Chairman and CEO until 1989, when he bought the Ellem Industria Farmaceutica from Farmitalia



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Carlo Erba together with the first private French pharmaceutical Group. After 2001 Giampaolo Zambelletti was responsible of the sale of Spanish Auna, French Neuf Telecom, Serbia Telekom, Entel Chile, Digitel Venezuela and Tim Perù. In addition to that, he had the responsibility of some specific tasks for Telecom Italia company and alliances in Brasil, Argentina and Turkey. He is board member of Telecom Italia International, Avea, Oger Telecom and Ojer Telekomunikasyon (Turkey).

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Item 6. Directors, Senior Management and Employees

Board Of Auditors

**6.3 BOARD OF AUDITORS**

The following table lists the members of the Telecom Italia Board of Auditors as of June 13, 2007, including the Alternate Auditors, with their respective positions and year of appointment. The current Telecom Italia Board of Auditors was appointed by the shareholders' meeting on April 13, 2006.

On April 16, 2007 the shareholders' meeting of Telecom Italia appointed Enrico Maria Bignami as Auditor (previously he was an Alternate Auditor and as such replaced Stefano Meroi, who resigned as an Auditor on October 20, 2006) and Luigi Gaspari Alternate Auditor.

| <u>Name</u>              | <u>Position</u>   | <u>Appointed</u> |
|--------------------------|-------------------|------------------|
| Paolo GOLIA              | Chairman          | 2006             |
| Enrico Maria BIGNAMI     | Auditor           | 2007             |
| Salvatore SPINIELLO      | Auditor           | 2006             |
| Ferdinando SUPERTI FURGA | Auditor           | 2006             |
| Gianfranco ZANDA         | Auditor           | 2006             |
| Luigi GASPARI            | Alternate Auditor | 2007             |
| Enrico LAGHI             | Alternate Auditor | 2006             |

The positions held by the members of the Board of Auditors in other listed companies are shown below:

|                          |  |
|--------------------------|--|
| Paolo GOLIA              |  |
| Enrico Maria BIGNAMI     | Chairman of the Board of Auditors of Biancamano S.p.A.   |
| Salvatore SPINIELLO      | Director of Fondiaria Sai S.p.A. and Immobiliare Lombarda S.p.A.; member of the board of auditors of Edison S.p.A. and of Telecom Italia Media S.p.A. (Telecom Italia Group) |
| Ferdinando SUPERTI FURGA | Independent director of Parmalat S.p.A.; chairman of the board of auditors of Arnoldo Mondadori Editore S.p.A.; member of the board of auditors of Edison S.p.A.             |
| Gianfranco ZANDA         |  |

For a detailed description of Telecom Italia's corporate governance, including activities and responsibilities of the Board of Auditors (acting as Audit Committee of the Company), see Item 10. Additional Information 10.1 Corporate Governance .

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

**External Auditors**

**6.4 EXTERNAL AUDITORS**

According to Italian law, the Shareholders Meeting held on May 6, 2004 re-appointed Reconta Ernst & Young as the audit firm of the Company for the three year period 2004-2006 (after a first appointment for the 2001-2003 three-year period), taking into consideration the favorable opinion of the Board of Auditors. Such audit engagement came to an end with the issue of the audit report on the financial statements for the year ended December 31, 2006.

It should be noted that Law 262/2005 (the protection of savings law) as amended by Legislative Decree 303/2006 (the corrective decree), amended the provisions of Legislative Decree 58/1998 (the Consolidated Law on Finance) concerning the rules governing the audit of issuers and their groups. The Law 262/2005 also fixed the total duration of audit engagements at nine years and prohibited the renewal of an engagement and the conferment of a new engagement for at least three years from the date of the end of the previous engagement. However, the transitional provision contained in Article 8.7 of Legislative Decree 303/2006 allowed companies to extend the appointment of their incumbent auditors (as of the date the Decree 303/2006 was implemented), so that the overall duration of such engagement be equal to nine fiscal years.

The Shareholders Meeting held on April 16, 2007 appointed Reconta Ernst & Young to audit the annual financial statements of Telecom Italia S.p.A., the consolidated annual financial statements of the Telecom Italia Group and the half-yearly reports for the fiscal years 2007, 2008 and 2009.

Italian audit principles require that, in cases of corporate groups, the audit firm of Telecom Italia should carry out the audit of the group's most important entities in terms of the nature of operations, in such a way that it can act as the main group audit firm and express a professional evaluation of the financial statements in their entirety. In addition, the specific procedure set forth by Telecom Italia (the Group Procedure for the Appointment of External Auditors) provides that the auditor of Telecom Italia is the principal auditor of the entire group headed by Telecom Italia and consequently is the auditor to be preferred in the conferral of appointments by subsidiaries for mandatory auditing.

As a result, the Ernst & Young audit network presently is the sole audit firm for all of the companies of the Telecom Italia Group.

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Item 6. Directors, Senior Management and Employees

Employees

**6.5 EMPLOYEES****6.5.1 EMPLOYEES AND CHANGES IN THE TELECOM ITALIA GROUP**

The following table sets out the number of employees of the Telecom Italia Group at December 31, 2006 and 2005 by Business Unit/Corporate Function:

|                           | Number of employees<br>as of December 31, |               |
|---------------------------|---|---------------|
|                           | 2006                                      | 2005          |
| Wireline                  | 55,705                                    | 56,987        |
| Domestic Mobile           | 11,218                                    | 11,720        |
| Brazil Mobile             | 9,531                                     | 9,043         |
| Media                     | 919                                       | 886           |
| Olivetti                  | 1,428                                     | 1,750         |
| Other activities          | 4,408                                     | 5,098         |
| <b>Consolidated Total</b> | <b>83,209</b>                             | <b>85,484</b> |

As of December 31, 2006, the Telecom Italia Group employed 83,209 employees (86,531 units at December 31, 2005, which included 1,047 employees relating to discontinued operations/assets held for sale).

The following table summarizes the changes during 2006 relating to the number of employees:

| Employees at<br>December 31,<br>2005(*) | Changes during the year |                          |   |  |                  | Employees at<br>December 31,<br>2006(*) |
|---|-------------------------|--------------------------|---|--|------------------|---|
|   | Hired                   | Terminated<br>employment | Decrease of<br>personnel with<br>temp work<br>contracts | Change in<br>scope of<br>consolidation | Total<br>changes |   |
| 86,531                                  | 6,086                   | (7,127)                  | (728)   | (1,553)                                | (3,322)          | 83,209                                  |

(\*) Include 3,382 and 2,654 personnel with temp work contracts at December 31, 2005 and 2006, respectively.

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As of December 31, 2006, the Telecom Italia Group had 83,209 employees. Compared to December 31, 2005 total employment was lower by 3,322, mainly attributable to the following factors:

- the hiring of 6,086 (of which 119 relating to discontinued operations/assets held for sale), the termination of 7,127 (of which 67 relating to discontinued operations/assets held for sale), and the decrease of 728 personnel with temp work contracts;
- the sale of Digitel Venezuela (915), Gruppo Buffetti (183), Telecom Italia Learning Services (195), Eustema (134), Wirelab (54) and the Radiomaritime Activities business (72).

The following table sets out the number of employees of the Telecom Italia Group at December 31, 2006 broken down by geographical area and function:

|                                   | Executives   | Middle<br>Management | White<br>collars | Blue<br>collars | Personnel<br>with temp<br>work<br>contracts | Total         |
|-----------------------------------|--------------|----------------------|------------------|-----------------|---|---------------|
| Italy                             | 1,207        | 4,277                | 61,262           | 431             | 1,646                                       | 68,823        |
| Europe (excluding Italy)          | 41           | 442                  | 2,262            |                 | 626   | 3,371         |
| Latin America                     | 45           | 357                  | 10,152           |                 | 382   | 10,936        |
| Other countries                   | 9            | 36                   | 34               |                 |   | 79            |
| <b>Telecom Italia Group Total</b> | <b>1,302</b> | <b>5,112</b>         | <b>73,710</b>    | <b>431</b>      | <b>2,654</b>                                | <b>83,209</b> |

### 6.5.2 INDUSTRIAL RELATIONS

Telecom Italia Group employees in Italy are represented by two categories of national unions, one for managerial staff and another for non-managerial staff. Employment agreements in Italy are generally collectively negotiated at the national level between the national employers associations and the workers unions and, for medium and

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large companies, also at company level. Renewals of collective agreements are subject to general guidelines agreed upon between the Italian Government, the employers' associations and trade unions. These guidelines establish that salary increases negotiated at the national level should not exceed agreed upon inflation rates. Individual companies may enter into additional contracts in order to link collective bonuses to company's productivity or profitability.

Approximately 2% of the Group's employees held executive positions on December 31, 2006.

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

Consistent with the agreement reached with trade unions in the 2005-2007 Industrial Plan (One Company Model) on February 27, 2006, the industrial procedure related to the merger by incorporation of Tim Italia into Telecom Italia has been accomplished. The integrated business model, representing a significant innovation in the telecommunications market and consisting in joint management of the fixed and mobile businesses, is based on technological infrastructure optimization, on integrated offer to customers and on the unification of processes and resources. At the same date an agreement has been subscribed with Unions in order to harmonize different treatments for employees of the above mentioned companies.

Following the agreements signed on December 20, 2005 with Trade Unions (which foresaw 3,500 employees enrolled in incentivized programs to encourage the employee to seek alternative professional developments, so called "mobility lists"), in 2006 the Group enrolled 1,246 employees in mobility lists (using as a priority identification criterion the early retirement option during mobility). Consistently with such agreements signed with Trade Unions, mobility *ex lege* 223/91 has been implemented on the basis of voluntary assent by the employees involved. These have been granted, upon termination of employment, in addition to TFR (end of employment settlement) to ensure appropriate income for the time until eligibility for retirement pension. More generally, mutually agreed employment termination has been implemented and, whenever possible, has been achieved through professional re-employment solutions.

The Group also signed agreements with the managers' bargaining Group on supplementary health assistance and complementary security for managers: on March 6, 2006 an agreement has been signed to redefine contributions to ASSIDA (Supplementary Health Assistance Fund for Group companies senior managers), in order to oppose the growing unbalance between operating managers and associated retired managers; on July 19, 2006 and November 9, 2006 agreements have been signed to define contributions to Fontedir (Supplementary Pension Fund for Telecom Italia managers), consistently with similar solutions adopted by Confindustria and Federmanager for the National Fund of the category.

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

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

**6.6.1 COMPENSATION OF DIRECTORS**

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

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

Such overall amount was distributed as follows:

- 114,000 to each director in office;
- an additional 63,000 to each of the members of the Internal Control and Corporate Governance Committee;
- an additional 52,000 to each of the members of the Remuneration Committee;
- an additional 20,000 to each of the members of the Strategy Committee other than the Chairman of the Board and the Managing Director Carlo Orazio Buora;
- an additional 20,000 to the director appointed to the Supervisory Panel set up under Legislative Decree 231/2001 (see Item 10. Additional Information 10.1 Corporate Governance 10.1.2 General Board of Directors Internal Control System ).

The total compensation paid by Telecom Italia and by the Telecom Italia Group subsidiaries in 2006 to the members of the Board of Directors of Telecom Italia was 13,000,000.

The General Shareholders' Meeting held on April 16, 2007, established the maximum total annual remuneration of the newly appointed Board of Directors (to remain in office until the approval of 2007 account), according to article 2389, first paragraph, of the Italian Civil Code up to 2,800,000.00, such amount to be divided amongst the directors in accordance with the resolution adopted by the Board itself in connection therewith.

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The above mentioned overall amount will be distributed as follows, in compliance with the resolution adopted by the Board of Directors on May 8, 2007:

- 114,000 to each director in office;
- an additional 70,000 to each of the members of the Internal Control and Corporate Governance Committee;
- an additional 40,000 to each of the members of the Remuneration Committee;
- an additional 20,000 to each of the members of the Strategy Committee other than the Chairman of the Board, the Executive Deputy Chairman and the Managing Director Riccardo Ruggiero;
- an additional 20,000 to the director appointed to the Supervisory Panel set up under Legislative Decree 231/2001.



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

The following table lists the Directors who served during 2006 and their respective compensation as of December 31, 2006. The compensation relates only to the period of 2006 in which they served as set forth below:

| <u>Name</u>              | <u>Position held</u>      | <u>Period during which position was held</u> | <u>Compensation base</u> | <u>Non cash benefits</u> | <u>Bonuses and other incentives</u> | <u>Other Compensations</u> |
|--------------------------|---------------------------|--|--------------------------|--------------------------|-------------------------------------|----------------------------|
|                          |                           |  |                          | (thousands of Euro)      |                                     |                            |
| Guido ROSSI<br>Gilberto  | Chairman                  | 9/16-12/31/2006                              | 684                      | 3                        |                                     |                            |
| BENETTON<br>Carlo Orazio | Deputy Chairman           | 1/1-12/31/2006                               | 114                      |                          |                                     |                            |
| BUORA                    | Managing Director         | 1/1-9/15/2006                                | 1,471                    | 8                        | 1,220(1)                            | 13(2)                      |
|                          | Executive Deputy Chairman | 9/16-12/31/2006                              | 692                      | 12                       |                                     |                            |
| Riccardo RUGGIERO        | Managing Director         |  |                          |                          |                                     |                            |
|                          | General Manager           | 1/1-12/31/2006                               | 829(3)                   | 8                        | 1,639(4)                            | 968(5)                     |
| Paolo BARATTA            | Director                  | 1/1-12/31/2006                               | 166(6)                   |                          |                                     |                            |
| John Robert Sotheby BOAS | Director                  | 1/1-12/31/2006                               | 114                      |                          |                                     |                            |
| Diana BRACCO             | Director                  | 4/13-12/31/2006                              | 85                       |                          |                                     |                            |
| Francesco DENOZZA        | Director                  | 1/1-12/31/2006                               | 177(7)                   |                          |                                     |                            |
| Domenico DE SOLE         | Director                  | 1/1-12/31/2006                               | 197(8)                   |                          |                                     |                            |
| Luigi FAUSTI             | Director                  | 1/1-12/31/2006                               | 166(6)                   |                          |                                     |                            |
| Guido FERRARINI          | Director                  | 1/1-12/31/2006                               | 197(9)                   |                          |                                     |                            |
| Jean Paul FITOUSSI       | Director                  | 1/1-12/31/2006                               | 114                      |                          |                                     |                            |
| Vittorio MERLONI         | Director                  | 4/13-12/31/2006                              | 85                       |                          |                                     |                            |
| Gianni MION              | Director                  | 1/1-12/31/2006                               | 114(10)                  |                          |                                     | 13(11)                     |
| Massimo MORATTI          | Director                  | 1/1-12/31/2006                               | 114                      |                          |                                     |                            |
| Marco ONADO              | Director                  | 1/1-12/31/2006                               | 197(8)                   |                          |                                     |                            |
| Renato PAGLIARO          | Director                  | 1/1-12/31/2006                               | 114(12)                  |                          |                                     |                            |
| Pasquale PISTORIO        | Director                  | 1/1-12/31/2006                               | 186(13)                  |                          |                                     |                            |
| Carlo A. PURI<br>NEGRI   | Director                  | 1/1-12/31/2006                               | 114                      |                          |                                     |                            |
| Luigi ROTH               | Director                  | 1/1-12/31/2006                               | 114                      |                          |                                     |                            |
| Marco TRONCHETTI         |                           |  |                          |                          |                                     |                            |
| PROVERA                  | Chairman                  | 1/1-9/15/2006                                | 1,658                    | 24                       | 1,365(14)                           |                            |
| Giovanni CONSORTE        | Director                  | 1/1-1/23/2006                                | 9                        |                          |                                     |                            |
| Enzo GRILLI              | Director                  | 1/1-10/29/2006                               | 95                       |                          |                                     |                            |
| Giuseppe SALA            | General Manager           | 1/1-5/31/2006                                |                          | 3                        | 1,827(15)                           | 3,853(16)                  |

(1) The amount includes variable remuneration ex art. 2389 paragraph 3 of the Italian Civil Code paid in 2006 since it was subject to reaching a consolidated operating income 2005 budget target, with a positive EVA change. With regard to 2007, the board of directors meeting held on March 7, 2006 approved additional remuneration of 1,250,000.00 which was increased by resolution of the board of directors meeting held on November 6, 2006 to 1,400,000.00, the payment of which, in 2007, is subject to reaching the economic and financial targets of the Group.

(2)

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Remuneration ex art. 2389, paragraph 1 of the Italian Civil Code for the position of Chairman of Tim Italia S.p.A. during the period 1/1-2/28/2006, not received but paid over to Telecom Italia S.p.A..

- (3) Remuneration ex art. 2389, paragraph 1 of the Italian Civil Code is not paid to the individual.
- (4) The amount includes remuneration paid in respect of Management By Objectives (MBO), one-off Services (for the contribution to the corporate integration process), one-off Retention and one-off Sundry Occasional services.
- (5) The amount includes gross compensation as an employee, remuneration ex art. 2389, paragraph 1 of the Italian Civil Code for the position of CEO of Tim Italia S.p.A. for the period 1/1-2/28/2006 and for the position of Chairman of Telecom Italia Sparkle S.p.A. for the period 4/1-12/31/2006, not received but paid over to Telecom Italia S.p.A..
- (6) The amount includes remuneration paid as a member of the Remuneration Committee.
- (7) The amount includes remuneration paid as a member of the Committee for Internal Control and Corporate Governance.
- (8) The amount includes remuneration paid as a member of the Committee for Internal Control and Corporate Governance and as a member of the Strategies Committee.
- (9) The amount includes remuneration paid as a member of the Committee for Internal Control and Corporate Governance and as a member of the Supervisory Panel under Legislative Decree 231/2001.
- (10) Remuneration not received but paid over to Edizione Holding.
- (11) The amount includes remuneration paid for the position of Deputy Chairman of the subsidiary Tim Italia S.p.A. from 1/1-2/28/2006, not received but paid over to Edizione Holding.
- (12) Remuneration not received but paid over to Mediobanca.
- (13) The amount includes remuneration paid as a member of the Remuneration Committee and as a member of the Strategies Committee.

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

(14) The amount includes variable remuneration ex art. 2389, paragraph 3 of the Italian Civil Code paid in 2006 since it was subject to reaching a consolidated operating income 2005 budget target, with a positive EVA change.

(15) The amount includes remuneration paid in respect of Management By Objectives (MBO), one-off Services, one-off Substitute MBO 2006 and one-off Retention.

(16) The amount includes gross compensation as an employee, compensation for unused holidays and for the termination of employment with Telecom Italia S.p.A., according to the general settlement.

The following tables list the stock options held by Mr. Ruggiero. Applicable Italian law requires disclosure of individual compensation in the form of stock options for members of the Board of Directors and for General Managers. The compensation in the form of stock options for Mr. Ruggiero was disclosed pursuant to legislative Decree No. 58/98 in the Telecom Italia Group's home jurisdiction Annual Report for the year ended December 31, 2006. See also below 6.7 Options to Purchase Securities from Registrant.

| Name     | Options held at the beginning of 2006 |                            |                         | Options granted during 2006 |                        |                         | Options exercised during 2006 |                        |                   | Options expired or lapsed in 2006 | Options held at the end of 2006 |                            |                         |
|----------|---------------------------------------|----------------------------|-------------------------|-----------------------------|------------------------|-------------------------|-------------------------------|------------------------|-------------------|-----------------------------------|---------------------------------|----------------------------|-------------------------|
|          | Number of options(*)                  | Average exercise price(**) | Average expiration date | Number of options           | Average exercise price | Average expiration date | Number of options             | Average exercise price | price during year | Number of options                 | Number of options(*)            | Average exercise price(**) | Average expiration date |
|          | (1)                                   | (2)                        | (3)                     | (4)                         | (5)                    | (6)                     | (7)                           | (8)                    | (9)               | (10)                              | (11)=                           | (12)                       | (13)                    |
| Riccardo | 750,000                               | 3.177343                   | 2007                    |                             |                        |                         |                               |                        |                   |                                   | 750,000                         | 3.177343                   | 2007                    |
| Ruggiero | 200,000                               | 2.788052                   | 2010                    |                             |                        |                         |                               |                        |                   |                                   | 200,000                         | 2.788052                   | 2010                    |

(\*) Each option corresponds to the subscription or purchase of 3.300871 Telecom Italia Ordinary Shares.

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

**6.6.2 COMPENSATION OF EXECUTIVE OFFICERS**

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The total compensation paid by the Company or by any of the Company's subsidiaries in 2006 to the Company's executive officers was 26,648,000.

The contracts with the executive officers contain the following clauses:

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

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

The annual compensation attributed to the Board of Auditors until the General Shareholders' Meeting of April 13, 2006 (which appointed the current Board of Auditors) was 128,000 for each Auditor and 171,000 for the Chairman of the Board, according to the resolutions by Telecom Italia's General Shareholders' Meeting of May 6, 2004. The shareholders' meeting of April 13, 2006 set the gross annual remuneration of each member of the Board of Auditors at 128,000 and the gross annual remuneration of the Chairman of the Board of Auditors at 171,000. It also decided to award an additional 20,000 to the member of the Board of Auditors appointed to the Supervisory Panel set up under Legislative Decree 231/2001 (Ferdinando Superti Furga).

The total compensation paid by the Company or by any of the Telecom Italia Group subsidiaries in 2006 to the members of the Board of Auditors was 705,000.

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

The following table sets forth the members of the Board of Auditors in office during 2006 and the compensation received by the Board of Auditors for services rendered during the year ended December 31, 2006:

| <u>Name</u>          | <u>Position held</u> | <u>Period during which position was held</u> | <u>Compensation base</u> | <u>Non cash benefits</u> | <u>Bonuses and other incentives</u> | <u>Other Compensations</u> |
|----------------------|----------------------|--|--------------------------|--------------------------|-------------------------------------|----------------------------|
| (thousands of Euro)  |                      |  |                          |                          |                                     |                            |
| Paolo GOLIA          | Acting Auditor       | 1/1-4/13/2006                                | 37                       |                          |                                     |                            |
|                      | Chairman             | 4/14-12/31/2006                              | 123                      |                          |                                     |                            |
| Enrico Maria BIGNAMI | Acting Auditor       | 10/21-12/31/2006                             | 25(1)                    |                          |                                     |                            |
| Ferdinando SUPERTI   |                      |  |                          |                          |                                     |                            |
| FURGA                | Chairman             | 1/1-4/13/2006                                | 55(2)                    |                          |                                     |                            |
|                      | Acting Auditor       | 4/14-12/31/2006                              | 105(2)                   |                          |                                     |                            |
| Salvatore SPINIELLO  | Acting Auditor       | 1/1-12/31/2006                               | 128                      |                          |                                     | 42(3)                      |
| Gianfranco ZANDA     | Acting Auditor       | 1/1-12/31/2006                               | 128                      |                          |                                     | 20(4)                      |
| Rosalba CASIRAGHI    | Acting Auditor       | 1/1-4/13/2006                                | 37                       |                          |                                     |                            |
| Stefano MEROI        | Acting Auditor       | 4/14-10/20/2006                              | 67                       |                          |                                     |                            |

(1) The amount includes remuneration not received but paid to the Bignami e Associati corporate and tax consulting firm.

(2) The amount includes remuneration paid as a member of the Supervisory Panel under Legislative Decree 231/2001.

(3) The amounts includes remuneration for the position of Acting Auditor of Telecom Italia Media S.p.A..

(4) The amount includes remuneration for the position of Chairman of the Board of Auditors of IT Telecom S.r.l. from 1/1-12/31/2006 and for the position of Acting Auditor of Tim Italia S.p.A. from 1/1-2/28/2006.

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

**Options to Purchase Securities From Registrant**

**6.7 OPTIONS TO PURCHASE SECURITIES FROM REGISTRANT**

At the end of 2006, the existing stock options plans relate to options which give the right to the subscription of new Telecom Italia Ordinary Shares (including the options at one time granted to TIM S.p.A.) and new Telecom Italia Media Ordinary Shares.

For further details, please see Note 42 Stock option plans of the Telecom Italia Group of the Notes to the Consolidated Financial Statements.

**Table of Contents****Item 7. Major Shareholders And Related-Party Transactions****Major Shareholders****Item 7. MAJOR SHAREHOLDERS AND RELATED-PARTY TRANSACTIONS****7.1 MAJOR SHAREHOLDERS**

At December 31, 2006, according to the shareholders register and other information in the Company's possession, the parties which held shares with voting rights, directly or indirectly, in excess of 2% of the ordinary share capital of Telecom Italia were the following:

|                               | <b>Type of<br/>ownership</b> | <b>No. Ordinary<br/>Shares</b> | <b>% of ordinary<br/>share capital</b> |
|-------------------------------|------------------------------|--------------------------------|--|
| Olimpia S.p.A.                | direct                       | 2,407,345,359                  | 17.99%                                 |
| Assicurazioni Generali S.p.A. | direct and indirect          | 636,242,171                    | 4.75%                                  |
| Hopa S.p.A.                   | direct and indirect          | 497,901,370                    | 3.72%                                  |

At December 31, 2006, Telecom Italia S.p.A. held 1,272,014 ordinary treasury stock, while the subsidiary Telecom Italia Finance S.A. held another 124,544,373 shares, for a total of 0.94% of capital with voting rights.

**7.1.1 THE SHAREHOLDERS AGREEMENTS**

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

Relations between the shareholders of Olimpia (currently the major shareholder of Telecom Italia, with a holding of approximately 18% of the ordinary share capital of the Company) are governed by an agreement dated August 7, 2001, and subsequently amended on September 14, 2001 and on February 13, 2002, containing clauses of relevance for Telecom Italia pursuant article 122 of Legislative Decree 58/1998. As of March 2, 2007 Edizione Holding S.p.A. was replaced by Sintonia S.p.A., and Edizione Finance International S.A. has changed its name to Sintonia S.A.

Under the shareholders' agreement (which is due to expire on October 4, 2007), Pirelli & C. S.p.A., on the one hand, and Edizione Holding S.p.A. and Edizione Finance International S.A. (now Sintonia S.p.A and Sintonia S.A., respectively; together: **Sintonia**), on the other, undertook to do everything in their power to ensure, within the limits allowed by law, that in the Board of Directors of Telecom Italia:

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- one-fifth of the directors (rounded to the nearest whole number up to two directors), whose appointment is not reserved by law, regulation or bylaw to the market or to other persons, are appointed as designated by Sintonia;
- the Deputy Chairman is appointed, with powers of legal representation from among the directors designated by Sintonia;
- if an Executive Committee is formed, one of its members is appointed from among the directors designated by Sintonia.

In addition, Pirelli & C. undertook to ensure, within the limits allowed by law, that no resolution is adopted by the Board of Directors of Telecom Italia without the favorable vote of at least one of the directors designated by Sintonia, if present, on the following matters:

- individual investments in excess of 250 million;
- the purchase, sale and disposal in any other manner of controlling interests or interests in affiliates in excess of 250 million on an individual basis;
- the disposal in any way of businesses or business units in excess of 250 million;
- proposals to call special shareholders meetings;
- transactions between the Telecom Italia Group and the Pirelli Group in excess of 50 million;
- transactions with related parties.

On July 12, 2006, Olimpia signed an agreement with Holinvest S.p.A. governing the former's continuing right of pre-emption on a portion (specifically 320,253,610 shares) of Telecom Italia Ordinary Shares held in Holinvest's



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

portfolio, which simultaneously undertook, both on its behalf and on behalf of its subsidiary Hopa S.p.A., not to increase the above-mentioned investment without the prior agreement of Olimpia. This agreement will be in effect until July 12, 2008.

Finally, an agreement was concluded on October 18, 2006 between Pirelli & C. S.p.A., Edizione Holding S.p.A. (now Sintonia S.p.A.), Edizione Finance International S.A. (now Sintonia S.A.), Olimpia S.p.A., Mediobanca S.p.A. and Assicurazioni Generali S.p.A., containing clauses of certain agreements relevant to Telecom Italia's management.

The agreement provides for a management board, composed of an even number of members, half of whom are designated by Olimpia (currently: Marco Tronchetti Provera, Chairman, and Gilberto Benetton) and, one by each of the other parties other than Pirelli and Sintonia (currently: Renato Pagliaro for Mediobanca and Giovanni Perissinotto for Generali). The agreement requires consultation among the parties before each Telecom Italia shareholders' meeting on how to exercise their voting rights relating to the shares covered by the agreement, with the understanding that each party may freely exercise the right to vote when the board does not reach a unanimous decision.

The following Telecom Italia Ordinary Shares were initially committed to the agreement, which is due to last for three years:

| <u>Party</u>      | <u>No. of Ordinary Shares</u> | <u>% of ordinary<br/>share capital</u> |
|-------------------|-------------------------------|--|
| Olimpia S.p.A.    | 2,407,345,359                 | 17.99%                                 |
| Generali Group    | 490,580,064                   | 3.67%                                  |
| Mediobanca S.p.A. | 206,464,069                   | 1.54%                                  |
|                   | <b>3,104,389,492</b>          | <b>23.20%</b>                          |

Such shares are covered by lock-up and standstill provisions, although the agreement also provides for a series of exceptions to such provisions. Olimpia's commitment not to transfer the Telecom Italia shares contributed to the pact, for example, can be disregarded if Olimpia decides to sell its entire stake. However, in that case, Generali and Mediobanca have a pre-emption right. This right cannot be exercised whenever the buyer agrees to purchase the shares of the same Generali and Mediobanca contributed to the pact at the same terms. The same procedure applies in the case of the sale by Pirelli, alone or with Sintonia, of a stake in excess of 50% of the capital of Olimpia.

Telecom Italia is not subject to direction and coordination pursuant to Article 2497 et seq. of the Italian Civil Code nor to the control of any person pursuant to Article 93 of the Consolidated Law. Olimpia is the largest shareholder in Telecom Italia, with a stake equal to, as of June 13, 2007, approximately 18%. Under the slate voting system for the election of directors, a shareholder or group of shareholders owning 1% or more of the shares may put forward a slate of directors for election to the Board. As a result of this system 15 of the directors elected at the shareholders' meeting of April 16, 2007 were candidates put forward by Olympia. See Item 10. Additional Information 10.1 Corporate Governance 10.1.2 General Board of Directors Appointment .

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There are no arrangements known to the Company the operation of which may result in any shareholder obtaining a controlling interest in Telecom Italia. See, however, the discussion below of the sale of Olimpia to Telco S.p.A.

On April 28, 2007 Pirelli & C. S.p.A., Sintonia S.p.A. and Sintonia S.A. announced by press release that they had reached an agreement with a group of institutional financial investors and Telefónica S.A., the Spanish telecoms operator for the sale of 100% of the share capital of Olimpia S.p.A..

The acquisition (which is conditional upon the authorisations and approvals of competent authorities) will be effected by a vehicle company (Telco S.p.A.) owned by Assicurazioni Generali S.p.A. (28.1%), Intesa Sanpaolo S.p.A. (10.6%), Mediobanca S.p.A. (10.6%), Sintonia S.A. (8.4%) and Telefónica S.A. (42.3%). The transaction is expected to be completed by October 2007. According to the co-investment agreement between Assicurazioni Generali S.p.A., Intesa Sanpaolo S.p.A., Mediobanca S.p.A., Sintonia S.A. and Telefónica S.A., the aforementioned agreement concluded on October 18, 2006 between Pirelli & C. S.p.A., Edizione Holding S.p.A. (now Sintonia

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

**Major Shareholders**

S.p.A.), Edizione Finance International S.A. (now Sintonia S.A.), Olimpia S.p.A., Mediobanca S.p.A. and Assicurazioni Generali S.p.A. shall cease to have any effect upon the acquisition by Telco S.p.A. of the entire share capital of Olimpia.

Telco S.p.A., after the acquisition and the incorporation of Olimpia S.p.A., will hold approximately 23.6% of the voting share capital of Telecom Italia S.p.A., 18% of which will be acquired with the acquisition of Olimpia and 5.6% of which will be contributed by Assicurazioni Generali S.p.A. and Mediobanca S.p.A..

The following chart illustrates the expected ownership structure following completion of the transaction.

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

The following table shows the ownership of Telecom Italia and Telecom Italia Media shares, as of June 13, 2007, by the Directors of Telecom Italia who were in office during 2006 (as well as of the directors appointed by the General Meeting of April 16, 2007).

| Name              | Company                     | Class of shares | Number of shares  |                          | Number of shares sold | Number of shares (or as of the date on which individual left post, if before) |
|-------------------|-----------------------------|-----------------|---|--------------------------|-----------------------|---|
|                   |                             |                 | held at the end of 2005 (or at the date of appointment) | held as of June 13, 2007 |                       |   |
| Guido ROSSI       | Telecom Italia S.p.A.       | Ordinary        | 185,000(1)  |                          |                       | 185,000   |
| Gilberto BENETTON | Telecom Italia S.p.A.       | Ordinary        | 1,946,250   |                          |                       | 1,946,250   |
| Diana BRACCO      | Telecom Italia S.p.A.       | Savings         | 990,000   |                          |                       | 990,000   |
|                   | Telecom Italia S.p.A.       | Savings         | 29,805  |                          |                       | 29,805  |
|                   | Telecom Italia Media S.p.A. | Ordinary        | 594   |                          |                       | 594   |
|                   | Telecom Italia S.p.A.       | Ordinary        | 38,308  |                          |                       | 38,308  |
| Renzo CAPRA       | Telecom Italia S.p.A.       | Ordinary        | 3,630   |                          |                       | 3,630   |
| Claudio DE CONTO  | Telecom Italia S.p.A.       | Ordinary        | 16  |                          |                       | 16  |
| Luigi FAUSTI      | Telecom Italia S.p.A.       | Ordinary        | 5,985   | 50,000(1)                |                       | 55,985  |
| Guido FERRARINI   | Telecom Italia S.p.A.       | Ordinary        |   | 50,000                   |                       | 50,000  |
| Aldo MINUCCI      | Telecom Italia S.p.A.       | Ordinary        | 2,595   |                          |                       | 2,595   |
| Gianni MION       | Telecom Italia S.p.A.       | Ordinary        | 27,000(1)   |                          |                       | 27,000  |
| Marco ONADO       | Telecom Italia S.p.A.       | Savings         | 35,000(1)   |                          |                       | 35,000  |
|                   | Telecom Italia S.p.A.       | Ordinary        | 17,000  | 30,000                   |                       | 47,000  |
| Renato PAGLIARO   | Telecom Italia S.p.A.       | Savings         | 11,092  |                          |                       | 11,092  |
|                   | Telecom Italia S.p.A.       | Savings         | 45,000  | 15,000                   |                       | 60,000  |
| Pasquale PISTORIO | Telecom Italia S.p.A.       | Ordinary        | 1,549,000(2)  |                          |                       | 1,549,000   |
| Luigi ROTH        | Telecom Italia S.p.A.       | Ordinary        | 36,292(1)   |                          |                       | 36,292  |
| Marco TRONCHETTI  | Telecom Italia Media S.p.A  | Ordinary        | 726(1)  |                          |                       | 726   |
|                   | Telecom Italia S.p.A.       | Ordinary        | 2,000,000   |                          |                       | 2,000,000   |
| PROVERA           | Telecom Italia S.p.A.       | Savings         | 1,000,000   |                          |                       | 1,000,000   |

(1) Shares held indirectly.

(2) Including 660,000 shares held indirectly.

**V BOARD OF AUDITORS**

The following table shows the ownership of Telecom Italia shares, as of June 13, 2007, by the auditors of Telecom Italia:

| <u>Name</u> | <u>Company</u> | <u>Class of shares</u> | <u>Number of shares held at the end of 2005 (or at the date of appointment)</u> | <u>Number of shares purchased</u> | <u>Number of shares sold</u> | <u>Number of shares held as of June 13, 2007 (or as of the date on which individual left post, if before)</u> |
|-------------|----------------|------------------------|---|-----------------------------------|------------------------------|---|
| Paolo GOLIA | Telecom Italia | Ordinary               | 1,437   |                                   |                              | 1,437   |

As of June 13, 2007 no member of the Board of Directors or Board of Auditors beneficially owned more than 0.0244192% of the Ordinary Shares or Savings Shares.

\* \* \*

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

The following table shows certain information, as of June 13, 2007, about the ownership of the Company's Ordinary Shares and Savings Shares by the Company's directors and executive officers as a group and by the members of the Board of Auditors as a group.

| <u>Title of Class</u> | <u>Owner</u>   | <u>Number Owned</u> | <u>% of class</u> |
|-----------------------|--|---------------------|-------------------|
| Ordinary Shares       | Directors and executive officers as a group (19 Directors and 11 Executive Officers) | 3,634,981           | 0.0271658%        |
|                       | Board of Auditors as a group (5 persons)   | 1,437               | 0.0000107%        |
| Savings Shares        | Directors and executive officers as a group (19 Directors and 11 Executive Officers) | 1,179,639           | 0.0195754%        |
|                       | Board of Auditors as a group (5 persons)   |                     |                   |

Effective from April 1, 2006, according to article 114, prf. 7, of legislative decree n. 58/1998, as amended by law n. 262/2005, and pursuant to ad hoc rules by CONSOB, persons performing administrative, supervisory and management functions in a listed issuer (including directors and auditors) and managers who have regular access to inside information (so called "privileged information", in accordance with the definition of law n. 262/2005) and the power to make managerial decisions affecting the future development and prospects of the issuer, persons who hold shares amounting to at least 10 per cent of the share capital, and any other persons who control the issuer must inform CONSOB and the public of transactions involving the issuer's shares (or the shares issued by the issuer's listed subsidiaries, and unlisted shares issued by subsidiaries of the listed issuer when the book value of the holding in the subsidiary represents more than fifty per cent of the listed issuer's assets) or other financial instruments linked to them that they have carried out directly or through nominees, for an amount equal to or above 5,000. Such disclosures must be performed within a five-trading day time limit and have also to be made when the transactions are carried out by the spouse, unless legally separated, dependent children, including those of the spouse, cohabitant parents and relatives by blood or affinity of the persons referred to above.

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

**7.1.3 CONTINUING RELATIONSHIP WITH THE ITALIAN TREASURY**

Since December 9, 2002, the Treasury has not held a direct holding in Telecom Italia. However, the Treasury continues to be in a position to exert certain powers with respect to Telecom Italia through the exercise of the special powers included in Telecom Italia's Bylaws. Such powers were established in 1997 according to Law No. 474/1994, when Telecom Italia formerly controlled by the Italian Treasury was privatized.

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

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

As a result, on April 1, 2005 a new Decree by the Minister for Economy and Finance, in agreement with the Minister for Productive Activities redefined accordingly the content of the special powers clause in Telecom Italia bylaws, and stated its exact wording. Therefore, as per the power entrusted to the Board of Directors by the Company's bylaws, according to Italian Civil Code, to resolve upon revisions of the bylaws, if necessary to conform with statutory provisions, on October 5, 2005 the Telecom Board of Directors amended the relevant provision.

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

**Related-Party Transactions**

**7.2 RELATED-PARTY TRANSACTIONS**

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

For further details, please see Note 41 Related party transactions of the Notes to the Consolidated Financial Statements included elsewhere in this Annual Report.



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**Item 8. Financial Information**

**Historical Financial Statements**

**Item 8. FINANCIAL INFORMATION**

**8.1 HISTORICAL FINANCIAL STATEMENTS**

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

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**Item 8. Financial Information**

**Legal Proceedings**

**8.2 LEGAL PROCEEDINGS**

For further details, please see Note 26 Contingent assets and liabilities, commitments and other guarantees and Note 48-Additional U.S. GAAP Disclosures Subsequent Events of the Notes to the Consolidated Financial Statements included elsewhere herein.

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

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

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

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

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

|  | Telematico |        | NYSE     |       |
|--|------------|--------|----------|-------|
|  | High       | Low    | High     | Low   |
|  | ( )        |        | (U.S.\$) |       |
| <b>2003:</b>                                   |            |        |          |       |
| Third Quarter from August 4 to September 30(1) | 2.3240     | 2.1040 | 26.31    | 23.57 |
| Fourth Quarter                                 | 2.4390     | 2.1130 | 29.92    | 24.75 |
| <b>2004</b>                                    |            |        |          |       |
| First Quarter                                  | 2.617      | 2.387  | 33.24    | 29.38 |
| Second Quarter                                 | 2.703      | 2.452  | 32.80    | 29.74 |
| Third Quarter                                  | 2.569      | 2.343  | 31.84    | 28.71 |
| Fourth Quarter                                 | 3.046      | 2.531  | 41.10    | 31.28 |
| <b>2005:</b>                                   |            |        |          |       |
| First Quarter                                  | 3.168      | 2.790  | 41.16    | 36.93 |
| Second Quarter                                 | 2.978      | 2.486  | 38.59    | 30.14 |
| Third Quarter                                  | 2.734      | 2.479  | 33.86    | 29.95 |
| Fourth Quarter                                 | 2.719      | 2.305  | 32.13    | 26.95 |
| <b>2006:</b>                                   |            |        |          |       |
| First Quarter                                  | 2.614      | 2.257  | 31.87    | 26.89 |
| Second Quarter                                 | 2.427      | 2.119  | 30.21    | 26.68 |
| Third Quarter                                  | 2.269      | 2.065  | 29.18    | 25.88 |

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|                              |       |       |       |       |
|------------------------------|-------|-------|-------|-------|
| Fourth Quarter               | 2.405 | 2.205 | 31.06 | 27.99 |
| <b>2007:</b>                 |       |       |       |       |
| January                      | 2.385 | 2.264 | 31.10 | 29.40 |
| February                     | 2.426 | 2.269 | 31.71 | 29.51 |
| March                        | 2.242 | 2.108 | 29.48 | 27.88 |
| April                        | 2.430 | 2.208 | 32.53 | 29.95 |
| May                          | 2.195 | 2.092 | 29.93 | 27.90 |
| June (through June 13, 2007) | 2.161 | 2.031 | 29.10 | 27.01 |

Source: Bloomberg data

- (1) The official prices of Shares for the periods prior to August 4, 2003 are not comparable to the official prices of these shares in the following periods due to the effect of the incorporation of Old Telecom Italia with and into Olivetti, which became effective on August 4, 2003. Please see 9.2 Trading of Old Telecom Italia Ordinary Shares and Savings Shares .

At the close of business on June 13, 2007 there were 49,095,013 Ordinary Share ADSs outstanding held by 131 registered holders. One of the registered holders is the Depository Trust Company ( **DTC** ) which holds 49,079,745 Ordinary Share ADSs on behalf of beneficial holders.

**Table of Contents****Item 9. Listing****Trading Of Telecom Italia Ordinary Shares And Savings Shares**

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

|  | Telematico |        | NYSE     |       |
|--|------------|--------|----------|-------|
|  | High       | Low    | High     | Low   |
|  | ( )        |        | (U.S.\$) |       |
| <b>2003:</b>                                   |            |        |          |       |
| Third Quarter from August 4 to September 30(1) | 1.5760     | 1.4320 | 19.00    | 16.09 |
| Fourth Quarter                                 | 1.6460     | 1.4650 | 20.90    | 17.33 |
| <b>2004</b>                                    |            |        |          |       |
| First Quarter                                  | 1.862      | 1.634  | 23.54    | 20.78 |
| Second Quarter                                 | 1.972      | 1.765  | 23.68    | 21.46 |
| Third Quarter                                  | 1.861      | 1.711  | 23.35    | 21.19 |
| Fourth Quarter                                 | 2.410      | 1.878  | 34.00    | 23.58 |
| <b>2005:</b>                                   |            |        |          |       |
| First Quarter                                  | 2.519      | 2.303  | 32.90    | 30.71 |
| Second Quarter                                 | 2.540      | 2.052  | 32.51    | 24.64 |
| Third Quarter                                  | 2.306      | 2.063  | 27.97    | 24.75 |
| Fourth Quarter                                 | 2.301      | 1.938  | 26.94    | 22.32 |
| <b>2006:</b>                                   |            |        |          |       |
| First Quarter                                  | 2.2402     | 1.9046 | 27.12    | 22.70 |
| Second Quarter                                 | 2.2092     | 1.9116 | 27.13    | 24.26 |
| Third Quarter                                  | 2.0384     | 1.8407 | 26.31    | 23.43 |
| Fourth Quarter                                 | 2.0434     | 1.8846 | 26.60    | 23.68 |
| <b>2007:</b>                                   |            |        |          |       |
| January  | 2.0235     | 1.9196 | 26.35    | 24.76 |
| February                                       | 2.0095     | 1.9116 | 26.20    | 24.75 |
| March  | 1.8936     | 1.8097 | 25.14    | 23.53 |
| April  | 1.9845     | 1.7500 | 26.32    | 23.87 |
| May  | 1.814      | 1.715  | 24.37    | 22.89 |
| June (through June 13, 2007)                   | 1.722      | 1.625  | 23.08    | 21.42 |

Source: Bloomberg data

(1) The official prices of Shares for the periods prior to August 4, 2003 are not comparable to the official prices of these shares in the following periods due to the effect of the incorporation of Old Telecom Italia with and into Olivetti, which became effective on August 4, 2003. Please see 9.2 Trading of Old Telecom Italia Ordinary Shares and Savings Shares .

At the close of business on June 13, 2007, there were 34,574,444 Savings Share ADSs outstanding held by 14 registered holders. One of the registered holders is the Depository Trust Company ( DTC ) which holds 34,570,581 Savings Share ADSs on behalf of beneficial holders.

Fluctuations between the Euro and the U.S. dollar will affect the dollar equivalent of the price of the Ordinary Share and the Savings Shares on Telematico and the price of the Ordinary Share ADSs and the Savings Share ADSs on the New York Stock

Exchange.

On June 13, 2007 the Noon Buying Rate for the Euro was U.S.\$ 1.3295 = 1.00.

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

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

|                                      | Telematico |      | NYSE     |       |
|--------------------------------------|------------|------|----------|-------|
|                                      | High       | Low  | High     | Low   |
|                                      | ( )        |      | (U.S.\$) |       |
| <b>2002:</b>                         |            |      |          |       |
| First Quarter                        | 9.73       | 8.55 | 88.75    | 75.18 |
| Second Quarter                       | 9.21       | 7.49 | 85.00    | 74.60 |
| Third Quarter                        | 8.35       | 7.08 | 83.20    | 71.35 |
| Fourth Quarter                       | 8.31       | 7.03 | 85.25    | 70.45 |
| <b>2003:</b>                         |            |      |          |       |
| First Quarter                        | 7.53       | 5.31 | 80.19    | 58.65 |
| Second Quarter                       | 8.14       | 6.61 | 94.43    | 70.14 |
| Third Quarter (until August 1, 2003) | 8.05       | 7.47 | 91.10    | 84.30 |

Source: Reuters data.

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

|                                      | Telematico |      | NYSE     |       |
|--------------------------------------|------------|------|----------|-------|
|                                      | High       | Low  | High     | Low   |
|                                      | ( )        |      | (U.S.\$) |       |
| <b>2002:</b>                         |            |      |          |       |
| First Quarter                        | 6.20       | 5.21 | 55.96    | 47.51 |
| Second Quarter                       | 6.14       | 4.94 | 57.00    | 50.32 |
| Third Quarter                        | 5.50       | 4.80 | 56.50    | 53.00 |
| Fourth Quarter                       | 5.38       | 4.77 | 56.33    | 48.67 |
| <b>2003:</b>                         |            |      |          |       |
| First Quarter                        | 4.90       | 3.35 | 52.00    | 37.50 |
| Second Quarter                       | 4.96       | 3.94 | 57.59    | 42.50 |
| Third Quarter (until August 1, 2003) | 5.08       | 4.64 | 53.75    | 52.92 |

Source: Reuters data.



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

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

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

Residents of Italy and non-residents through their authorized agents may purchase or sell shares on Telematico, subject to satisfying (i) in case of sales, either the Margin or the Deposit, and (ii) in case of purchases, the Margin. Margin means a deposit equal to 100% of the agreed price, and Deposit means a deposit of an equal number of the same shares as those sold. If in the course of a trading day the maximum price variation between two consecutive contracts is  $\pm 5\%$ , or maximum price variation of the contracts with respect to the control price<sup>(3)</sup> is  $\pm 10\%$  an automatic five-minute suspension is declared. In the event of such a suspension, effect is not given to trades agreed but not confirmed before the suspension. In addition, Borsa Italiana has the authority to suspend trading in any security in response to extreme price fluctuations or for other reasons.

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

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

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

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

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**Clearance And Settlement Of Telecom Italia Shares**

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

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

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

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

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**Item 10. ADDITIONAL INFORMATION**

**10.1 CORPORATE GOVERNANCE**

**10.1.1 DIFFERENCES IN TELECOM ITALIA S CORPORATE GOVERNANCE AND NEW YORK STOCK EXCHANGE CORPORATE GOVERNANCE PRACTICES**

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

*Independent Directors.* Under NYSE listing rules applicable to US companies, independent directors must comprise a majority of the board of directors.

Article 147-ter of the Italian Consolidated Law on Finance requires Boards, with more than seven members, to have at least two directors who meet the criteria set forth by Article 148 for the independence of statutory auditors; in addition the Borsa Italiana Corporate Governance Code requires Boards to have an adequate number of independent directors, while defining ad hoc independence criteria to this end.

As of June 13, 2007, 9 out of 19 members of Telecom Italia Board are deemed to be independent according to the Borsa Italiana Corporate Governance Code (and Telecom Italia Self-Regulatory Code, which incorporates by reference the same independence criteria set forth by the Borsa Italiana Code); in addition at least 6 Directors qualify as independent pursuant to the requirements set forth by Article 148.

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

*Non-management Directors Meetings.* Pursuant to NYSE listing standards, non-management directors must meet on a regular basis without management present and independent directors must meet separately at least once per year.

Borsa Italiana's Corporate Governance Code requires independent directors to meet separately at least once a year.

Since 2004, the Board of Directors decided it was desirable to appoint a Lead Independent Director, with the aim of further enhancing the role of the independent directors and Article 5.5 of the Company's Self Regulatory Code formalized this position, which was held by Professor Guido Ferrarini, Chairman of the Internal Control and Corporate Governance Committee, until the term of his office as director ended on April 16, 2007. After its composition changed (General Shareholders Meeting on April 16, 2007) the Board of Directors has not yet designated the new Lead Independent Director. During 2006, five Independent Directors Executive Sessions were held; the subjects discussed included strategic scenarios and the possible reorganization of the Group. See also below under 10.1 Corporate Governance 10.1.2 General Board of Directors Executive Directors and Activities of the Board .

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

According to Borsa Italiana's Corporate Governance Code, the Board of Directors shall evaluate whether to establish among its members a nomination committee, while an internal control committee is required.

Telecom Italia does not have a Nominating Committee. Directors are appointed by shareholders through the slate system which permits shareholders, who alone or together, hold shares representing at least 1% of the share capital to put forward slates of directors; the system is intended to ensure the presence on the Board of persons

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elected from slates submitted by minority shareholders. Thus, the Company took the view that using the slate system met the needs otherwise served by the creation of a Nominating Committee. Article 9 of Telecom Italia bylaws already provided for the members of the Board of Directors to be elected using the slate system, when the Consolidated Law on Finance made this system mandatory, as of 2006.

On the other hand Telecom Italia does have an Internal Control and Corporate Governance Committee, made up of independent directors and, among its other activities, this committee actively participates and assists in developing and implementing the corporate governance procedures adopted by Telecom Italia. Furthermore, Article 14 of Telecom Italia new Self Regulatory Code provides that, in cases of substitution of an independent director the Internal Control and *corporate governance* Committee proposes candidates for appointment to the Board of Directors.

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

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

The Borsa Italiana's Corporate Governance Code requires the Board to establish a remuneration committee made up of non-executive directors, the majority of which are independent.

In accordance with Telecom Italia's by-laws and the Self-Regulatory Code, the Board of Directors determines the remuneration of the Chairman and the Managing Directors. Such determination is made on the basis of proposals defined by the Remuneration Committee (made up of independent directors only, which provides also advice regarding remuneration criteria for the Company's senior management).

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

*Audit Committee.* US companies listed on the NYSE are required to establish an audit committee that satisfies the requirements of Rule 10A-3 under the 1934 Act.

The Board of Auditors, as permitted by Rule 10A-3, is performing the corresponding functions for Telecom Italia, which therefore is exempted from the requirement to have a separate audit committee. A Rule 303A written affirmation to this end was submitted to NYSE on June 13, 2006. In addition on October 26, 2006 an interim written affirmation was submitted to NYSE, since a statutory auditor had resigned and had been replaced by the alternate auditor purposely designed. See also below under 10.1 Corporate Governance 10.1.2 General Board of Directors Internal Control System and 10.1.2 General Board of Directors Board of Auditors .

*Adoption and Disclosure of Corporate Governance Guidelines.* US companies listed on the NYSE are required to adopt and disclose corporate governance guidelines.

Such disclosures are included in this Form 20-F and English translations of the Telecom Italia Group's corporate governance policies can be found on Telecom Italia's website: [www.telecomitalia.it](http://www.telecomitalia.it) under Governance .

*Code of business conduct and ethics.* NYSE listing standards require US companies to adopt a code of business conduct and ethics for directors, officers and employees, and promptly disclose any waivers of the code for directors or executive officers. The code should provide for the reporting of violations of its provisions or of laws and regulations.

Telecom Italia has adopted such a Code. See also below under 10.1 Corporate Governance 10.1.2 General Code of Ethics and Conduct .

*Annual Certification by The Chief Executive Officer.* A chief executive officer of a US company listed on the NYSE must annually certify that he or she is not aware of any violation by the company of NYSE corporate governance standards.

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In accordance with NYSE listing rules applicable to foreign private issuers, Telecom Italia submitted its foreign private issuer annual written affirmation on June 13, 2006.

**10.1.2 GENERAL**

In general, the Company's corporate governance system is made up of a series of principles, rules and procedures drawn by applicable laws and regulations and from international best practices. The system, designed and constructed bearing in mind the principles formulated by the Committee for Corporate Governance of Borsa Italiana, has been implemented with the adoption of codes, regulations and policies covering the activity of all the organizational and operational components of the Company. These documents (available in an English language version on the Internet at [www.telecomitalia.it](http://www.telecomitalia.it) under "Governance") are:

- the Group Code of Ethics and Conduct;
- the Company's Self-Regulatory Code;
- the Related Parties Procedure;
- the Procedure for Information to Directors and Auditors;
- the Disclosure Committee Rules;
- the Group Procedure for the Appointment of External Auditors;
- the Procedure for the management and public disclosure of inside information;
- the Organizational Model 231;
- the Meeting Regulations;
- the Risk Management Process (CRSA - Control Risk Self Assessment).

The above documents are reviewed regularly and updated to reflect legislative and regulatory developments and changes in international practices. In particular, the Company's corporate Governance tools have been revised to conform with legislation on protection of savings (Law n. 262/2005 and Legislative Decree 303/2006) and the so-called Market Abuse Directive. The review (which was finalized in March 2007) has also taken into account the March 2006 edition of the Corporate Governance Code by



Borsa Italiana.

According to new article 124-bis of the Consolidated Law on Finance, listed issuers shall annually disclose information on their adoption of and, in case, compliance with codes of conduct promoted by management companies of regulated markets (such as the aforementioned Corporate Governance Code by Borsa Italiana) or by trade associations of market participants.

## V CODE OF ETHICS AND CONDUCT

The Code of Ethics and Conduct (the **Code of Ethics**) of the Telecom Italia Group is central to Telecom Italia Group's system of corporate governance as it spells out the Company's fundamental values and the principles considered necessary to ensure an ethically oriented conduct of business. The Code can be considered as the lying upstream of the whole corporate governance system, since every instrument of corporate governance is based on the principles of transparency, fairness and loyalty specified in the Code. The Code has been gradually adopted by all the companies belonging to the Telecom Italia Group since it specifies the principles to be respected in relations with all the main stakeholders the members companies interact with on a daily basis: shareholders, financial markets, customers, local communities and employees.

The Code of Ethics was drawn up on the basis of generally accepted ethical principles and in accordance with the highest international standards, taking into account the principles of Section 406 of the Sarbanes Oxley Act concerning:

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

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- internal reporting of alleged violations of the Code of Ethics; and
- accountability for compliance of the Code of Ethics.

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

As with all of the Company's corporate governance codes and principles, the Code of Ethics is reviewed periodically in order to conform it to the developments in the applicable law and market regulations, taking into account the most advanced national and international practices.

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

## **V BOARD OF DIRECTORS**

The Company's system of corporate governance focuses on the central role of the Board of Directors in providing strategic guidance and in monitoring the operations, ensuring transparency of decisions, both within the Company and in relation to the market. The Telecom Italia Self-Regulatory Code supplements the applicable rules concerning the tasks and functioning of the Board of Directors. All the directors are required to comply with the Self-Regulatory Code. The Self-Regulatory Code has been adopted by the Board of Directors as a self-regulatory measure only and can therefore be amended at any time with a resolution adopted by the Board and promptly disclosed to the market. On March 2007, as part of the process of revising the Company's mechanism of corporate governance, the Board approved a new version of this Code.

In 2005, in line with the best international practices and before it was recommended by Borsa Italiana's new Corporate Governance Code (2006 edition), Telecom Italia's directors had carried out a Board performance evaluation.

In 2006, for the second Board evaluation, the Directors hired an outside consultant (Egon Zehnder International) to work alongside the independent director chosen to act as an internal facilitator, both in preparing and performing the self-evaluating methodologies and in processing the results obtained. The consultant issued a professional opinion based on the evaluation of factors as independence, size and composition of the Board, role and functioning of the Board and the Board's committees, flow of information, decision making procedures, relations with shareholders and stakeholders.

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

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The Board of Directors has the power (and the duty) to lead the Company by pursuing the main objective of creating value for its shareholders; to that end the Company's Self-Regulatory Code reserves to the Board's several important tasks, including the following:

examining and approving the strategic, business and financial plans of the Company and the Group;

evaluating and approving the annual budget of the Company and the Group;

examining and approving transactions including investments and divestments with a substantial impact on the Company's activity in view of their nature, strategic importance or size;

verifying the adequacy of the general organizational and administrative structure of the Company and the Group;

preparing and adopting the Company's corporate governance rules and the Group's governance guidelines;

appointing the Supervisory Panel set up under Legislative Decree 231/2001;

nominating the persons who are to hold the offices of Chairman and Managing Director in strategic subsidiaries;

assessing the overall performance of operations and periodically comparing the results achieved with those planned;

evaluating and approving the periodic reports required by the applicable legislation.

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***Meetings***

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

In 2006 the Board of Directors met eight times. Board meetings were always well attended, with more than 92% of the directors present on average (the independent directors recorded an attendance rate of more than 92%).

When board meetings were to be held, documentation permitting effective participation in the proceedings was normally provided well in advance. As part of the revision of the corporate governance mechanisms mentioned above, the Company has adopted a new procedure governing the flow of information to the members of the Board of Directors and the Board of Auditors. The new procedure (which incorporates that introduced in the past to comply with the information requirement laid down by Article 150 of the Consolidated Law on Finance) is finalized to coordinate all the mechanisms necessary to provide the directors and the statutory auditors with the pertinent and relevant information on a continuous basis.

In November 2006, the Company released the calendar of corporate events scheduled for 2007, listing the meetings planned for the Board of Directors during the year.

***Appointment of Directors***

As noted above, Telecom Italia's bylaws provide for the Board of Directors to be elected by the Shareholders Meeting through the slate system, which became mandatory under the Consolidated Law on Finance and the legislation on protection of savings.

The slate system is designed to ensure an adequate presence on the Board of Directors of persons drawn from slates presented by minority shareholders. According to Telecom Italia's Bylaws the slates of candidates are presented by the shareholders or by the outgoing Board of Directors. Only those shareholders who alone or together with other shareholders hold a total number of Ordinary Shares representing at least 1% of the share capital entitled to vote at the Shareholders Meeting (or less, according to CONSOB regulations) may submit slates. Individual candidates are required to submit curricula setting out their personal and professional data, with the indication, where appropriate, of the grounds for their qualifying as independent, in order to allow the shareholders to exercise the right to vote in an informed manner. Each person entitled to vote may vote for only one slate. Four-fifths of the directors to be elected are chosen from the slate that obtains the highest number of shareholders' votes in the progressive order in which they are listed on the slate. The remaining directors are chosen from the other slates; the votes obtained by the various slates are successively divided by one, two, three, four or five, depending on the number of directors to be chosen, and the quotients obtained are assigned progressively to candidates on each of these slates, in the order respectively specified on the slate. The quotients thus assigned to the candidates on the various slates are arranged in a single decreasing order. Those candidates who have obtained the highest quotients are elected to the Board of Directors.

At the April 2007 Shareholders Meeting the slate of candidates proposed by Olimpia obtained the highest number of votes and therefore 15 out of 19 of Telecom Italia's Directors were elected from that slate. See: Risks associated with Telecom Italia's ownership chain under Item 3. Key Information 3.1 Risk Factors .

### ***Composition***

According to the bylaws, the Board of Directors has not less than 7 and not more than 23 members; it is up to the shareholders meeting to decide the exact number. Directors may serve for a maximum term of three years, they may be re-elected and there is no statutory age limit for their eligibility. There are no provisions in Italian law that set age or shareholding requirements for directors' qualification. There are no provisions in the Telecom Italia Bylaws relating to the retirement of a director under an age limit requirement or the number of shares required for director's qualification.

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

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Relations between the shareholders of Olimpia (as of June 13, 2007 Telecom Italia s largest shareholder with an interest of approximately 18% in the Company s Ordinary Share of capital) are regulated by an agreement concluded on August 7, 2001 and subsequently amended on September 14, 2001 and February 13, 2002. As of March 2, 2007 Edizione Holding S.p.A. has been replaced by Sintonia S.p.A., while Edizione Finance International S.A. has changed its name to Sintonia S.A..

Under the agreement (which is due to expire on October 4, 2007) Pirelli S.p.A., on one hand, and Edizione Holding S.p.A. and Edizione Finance International S.A. (now respectively Sintonia S.p.A. and Sintonia S.A., and jointly: Sintonia), on the other, undertook to do everything in their power to ensure, within the limits established by law, that in Telecom Italia s Board of Directors:

- one-fifth of the Directors (rounded up to the nearest whole number up to two) whose designation is not reserved by law or regulation or bylaws to the market or other persons, are appointed as indicated by Sintonia;
- the Deputy Chairman is appointed, with powers of legal representation, from among the directors nominated by Sintonia;
- if an Executive Committee is set up, one of its members is appointed from among the directors designated by Sintonia.

On April 28, 2007, a group of investors (the **Investors** ), made up of 1) Assicurazioni Generali S.p.A., Sintonia S.A., Intesa Sanpaolo S.p.A., Mediobanca S.p.A. (the **Italian Investors** ) and 2) Telefónica S.A., entered into a Co-Investment Agreement establishing terms and conditions for their participation in Telco, a vehicle through which they intend to purchase the entire share capital of Olimpia, from Pirelli and Sintonia S.p.A. and Sintonia S.A. (together **Sintonia Sellers** ).

On May 4, 2007, the Investors entered into a Share Purchase Agreement with Pirelli and Sintonia Sellers to purchase the entire capital share of Olimpia. See also Item 7. Major Shareholders and Related-Party Transactions 7.1 Major Shareholders 7.1.1 The Olimpia Shareholders Agreements. According to the Shareholders Agreement entered into on April 28, 2007 by the Investors, as soon as possible after the closing of the Share Purchase Agreement, the Board of Directors of Telco or Olimpia, as the case may be, shall approve the list to be submitted to the shareholders meeting of Telecom Italia, for the appointment of the directors of Telecom Italia, pursuant to the following criteria: (i) Telefónica to the extent holding at least 30% of Telco s share capital shall have the right vis-à-vis the other parties to designate two directors of Telecom Italia to be included as designees for appointment in the Board of Telecom Italia in the list presented by Olimpia or Telco (as the case may be) and, to the extent feasible, pursuant to article 2386, first paragraph, of the Italian Civil Code (i.e. through appointment) and (ii) the Italian Investors to the extent holding at least 50% plus one share of Telco s share capital shall designate the other members of the list as follows: (a) three members unanimously and (b) the remaining members on the basis of a proportionality criterion (i.e. 1/5 each for Intesa Sanpaolo S.p.A., Sintonia S.A. and Mediobanca S.p.A. and 2/5 for Assicurazioni Generali S.p.A.).

In accordance with the Shareholders Agreement, the directors designated by Telefónica in Telco, Olimpia and Telecom Italia shall be directed by Telefónica to neither participate nor vote at the Board of Directors meetings at which resolutions will be discussed

and proposed relating to the policies, management and operations of companies directly or indirectly controlled by Telecom Italia providing services in countries where regulatory and legal restrictions or limitations for the exercise of voting rights by Telefónica are in force.

***Independent Directors***

The Company's Self Regulatory Code adopted specific criteria conforming to international best practice and the Borsa Italiana's Corporate Governance Code (2002 version) to qualify directors as independent, before the March 2006 edition of the Borsa Italiana's Corporate Governance Code. Presently, Article 5 of the new version of the Telecom Italia Self Regulatory Code (March 2007) incorporates by reference the independence criteria set out in the latest version of the Borsa Italiana's Corporate Governance Code. On the basis of these criteria and in the light of the declarations made by the parties concerned and verified by the Board of Directors, at present 9, out of

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the 19 directors, are considered independent, namely Paolo Baratta, Diana Bracco, Stefano Cao, Renzo Capra, Domenico De Sole, Luigi Fausti, Jean Paul Fitoussi, Cesare Giovanni Vecchio and Luigi Zingales.

To qualify as independent under the Company's Self-Regulatory Code, Telecom Italia directors should not maintain, nor have recently maintained, directly or indirectly any business relationships with the issuer or persons linked to the issuer (Group companies, executive directors or members of their families), of such a significance as to influence their autonomous judgment, and should not be in a position to influence the Company as a consequence of the shares they hold or their participation in shareholders' agreements. In particular, a director is presumed not to be independent, when:

- a) he/she controls, directly or indirectly, the issuer, or is able to exercise over the issuer dominant influence, or participates in a shareholders' agreement through which one or more persons may exercise a control or considerable influence over the issuer;
- b) he/she is, or has been in the preceding three fiscal years, a relevant representative of the issuer, of a subsidiary having strategic relevance or of a company under common control with the issuer, or of a company or entity controlling the issuer or able to exercise over the same period a considerable influence, also jointly through a shareholders' agreement;
- c) he/she has, or had in the preceding fiscal year, directly or indirectly a significant commercial, financial or professional relationship:

with the issuer, one of its subsidiaries, or any of its significant representatives;

with a subject who, jointly with others through a shareholders' agreement, controls the issuer, or in case of a company or an entity;

with the relevant significant representatives;

or is, or has been in the preceding three fiscal years, an employee of the above mentioned subjects;

- d) he/she receives, or has received in the preceding three fiscal years, from the issuer or a subsidiary or holding company of the issuer, a significant additional remuneration compared to the fixed remuneration of a non executive director of the issuer, including the participation in incentive plans linked to the company's performance, such as stock option plans;
- e) he/she was a director of the issuer for more than nine years in the last twelve years;
- f) he/she is vested with the executive director office in another company in which an executive director of the issuer holds the office of director;
- g)



he/she is shareholder or quota holder or director of a legal entity belonging to the same network as the company appointed for the accounting audit of the issuer; and

h) he/she is a close relative of a person who is in any of the positions listed in the above points.

The Board of Directors verifies after the appointment by the shareholders meeting which members of the Board meet the above referred independence requirements. In this regard, the abovementioned criteria are neither exhaustive nor mandatory: a director may be deemed independent even though he/she does not formally meet one or more of the aforementioned criteria; vice-versa a director who satisfies all the requirements may nevertheless be deemed not independent.

The Board of Auditors verifies the correct application of principles and procedures adopted by the Board to evaluate the independence of Directors.

As mentioned above, Article 5.5 of the Company's new Self Regulatory Code (March 2007) formalized the role of the Lead Independent Director, who was initially appointed, on September 9, 2004, in the person of the Chairman of the Internal Control and Corporate Governance Committee (Mr. Ferrarini). The Lead Independent Director coordinates the needs and inputs of the independent directors and, in performing this task, may use the Company's structures and call special meetings of independent directors ( Independent Directors Executive Sessions ) to discuss issues related to the functioning of the Board or the management of the business. The Chairman of the Board benefits from the collaboration of the Lead independent Director to improve the working of the Board.

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During 2006, five Independent Directors Executive Sessions were held; they were focused, among other matters, on strategic plans and on the possible reorganization of the Group.

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

The authority to grant delegated powers to directors and revoke such mandates is reserved to the Board of Directors, which also establishes the limits of such powers, the manner in which they have to be exercised and the intervals not more than three months at which executive directors must report to the Board of Directors and the Board of Auditors on the activity performed under the mandates conferred on them. The authority to determine the duties and responsibilities of the general managers is also reserved to the Board of Directors.

Telecom Italia adopted an *ad hoc* procedure formalizing the rules for gathering and transmitting information to the Board of Auditors and the Board of Directors on the activity performed, transactions with major implications for the profitability, financial position and/or balance sheet of the Company and the Telecom Italia Group, transactions with related parties (including intra-group dealings) and atypical or unusual transactions (the Procedure for Information to Directors and Auditors). This procedure generates the information flows by means of which executive directors report to the Board of Directors and the Board of Auditors.

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

- the activity carried out by the Company, with special reference to the implementation of transactions already approved by the Board of Directors and the actions taken by executive directors in the exercise of their delegated powers, including the projects launched;
- the transactions of greatest significance for the Company's profitability, financial position and balance sheet;
- any transactions potentially involving a conflict of interest, i.e. intra-group transactions and transactions with related parties other than those of an intra-group nature;
- atypical and unusual transactions, in which the parties or the nature of the transaction fall outside the normal sphere of the Company's business and that have critical aspects in relation to their nature, the risks inherent in the type of the counterparty or the time of their implementation.

On May 6, 2004 the Board of Directors appointed Marco Tronchetti Provera as Chairman and Carlo Orazio Buora and Riccardo Ruggiero as Managing Directors; Gilberto Benetton was appointed as Deputy Chairman.

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Following the resignation of the Chairman, Marco Tronchetti Provera, on September 15, 2006, the Board of Directors appointed Guido Rossi as Chairman and Carlo Orazio Buora as Executive Deputy Chairman. The latter was entrusted with the powers and responsibilities previously assigned to Marco Tronchetti Provera. Moreover, the Board confirmed Gilberto Benetton in the position of Deputy Chairman and Riccardo Ruggiero in that of Managing Director.

Following the Shareholders Meeting, held on April 16, 2007, the newly elected Board of Directors, on April 17, appointed as Chairman Pasquale Pistorio and confirmed Carlo Orazio Buora and Riccardo Ruggiero in their role, respectively as Executive Deputy Chairman and as Managing Director.

According to Italian law and the Company's Bylaws the Chairman and the Managing Directors (including the Executive Deputy Chairman) are all legal representatives of the Company and they are individually authorized to carry out any transaction relating to the Company's activity. Nevertheless, the power to take decisions on transactions of particular significance continues to be exercised by the Board as a whole, even when they are theoretically within the limits of the executive directors' mandates. This is because mandates are not considered a way of attributing exclusive competences but as a means of ensuring, from the standpoint of organizing the management function, the greatest possible operational flexibility, both within the Company and in relation to third parties.

In 2002, the Company adopted guidelines for carrying out transactions with related parties in order to ensure both procedural and substantial fairness and transparency: to this end Telecom Italia adopted the notion of "related party" spelled out in IAS 24, as suggested by CONSOB, the Italian authority competent to supervise

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financial markets. Under the guidelines, the Board of Directors is required to give advance approval to transactions with related parties, including intra-group transactions, apart from those of a customary nature to be concluded at standard conditions. Moreover, if the related party is a director or a third party that is related via a director, the director concerned may only provide clarifications and must leave the meeting when the motion is examined and voted upon. Depending on the nature, value and other characteristics of related-party transactions, the Board may be assisted by one or more experts, in order to prevent contracts being concluded at inappropriate conditions. Such experts must have suitable professional experience and qualifications in the relevant field and their independence and freedom from conflicts of interests must be carefully assessed.

In 2006, the Board of Directors approved a specific procedure (the Related Parties Procedure) to complement the aforementioned guidelines (now incorporated in the Company's new Self Regulatory Code: Article 11). The procedure is intended to ensure; (i) the standardized treatment of the issue; (ii) the identification of decision-making responsibilities; and (iii) the traceability of the operational processes. In particular, the procedure provides for the existence of a relationship with Telecom Italia to be checked in advance by consulting an expert system, which uses a database of related parties to Telecom Italia. The expert system provides automatic indications concerning decision-making procedures (including the need for an expert opinion) and internal information flows for reporting purposes.

For additional information, see [Item 7. Major Shareholders and Related-Party Transactions](#) [7.2 Related-Party Transactions](#) .

**Internal Committees**

According to article 13 of the Bylaws, the Board may set up committees from among its members charged with giving advice and making proposals and shall establish their powers and duties. According to the Self Regulatory Code (March 2007 edition), the Board establishes three Committees: the Strategy Committee, the Remuneration Committee, the Internal Control and Corporate Governance Committee.

***Strategy Committee***

The Committee is entrusted with the task of assisting the Board of Directors in formulating the Group's strategic choices, with special reference to decisions concerning technology, organizational finance and corporate finance. The Committee reports on its activity to the Board of Directors at least once a year, at the time the budget is presented. The Committee may invite to its meetings the heads of units within the Company and may employ consultants and external experts.

In 2006 the Strategy Committee consisted of the Chairman of the Board (who ensured the alignment and coordination of the activities of the Committee, the Board and management), the Managing Director (and, since September 15, 2007, Executive Deputy Chairman, Carlo Orazio Buora), and three non-executive directors (Domenico De Sole, Marco Onado and Pasquale Pistorio) specialized in the fields of competence reserved to the Committee. It met three times, with an attendance rate of 93%. The meetings were attended by managers of the Group, invited according to their specific expertise to provide inputs with regard to the matters on the agenda.

The present Board of Directors appointed the members of the current Strategy Committee in the persons of: the Chairman of the Board (Pasquale Pistorio), the Deputy Executive Chairman (Carlo Orazio Buora), the Managing Director (Riccardo Ruggiero), and four directors, Paolo Baratta, Domenico De Sole, Jean-Paul Fitoussi e Renato Pagliaro.

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

The Committee is entrusted with the following tasks:

- (i) to evaluate the adequacy of the internal control system;
- (ii) to evaluate the work plan prepared by the person in charge of the oversight of the internal control system, from whom it receives periodic reports;
- (iii) to discuss with the heads of the Company's administrative departments and the external auditors, and subsequently to assess, whether the accounting policies have been correctly applied and are homogeneous for the purpose of preparing the consolidated accounts;

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- (iv) to evaluate the proposals made by the external auditors in order to be awarded the appointment, the audit plan and the results set out in the letter of suggestions;
- (v) to report to the Board of Directors at least once every half year on the activity performed and the adequacy of the internal control system;
- (vi) to perform the additional tasks that may be assigned to it by the Board of Directors, particularly as regards relations with the external auditors; and
- (vii) to monitor compliance with the rules of corporate governance and the periodic updating thereof.

In March 2007 the Company revised the Self Regulatory Code in order to conform to the latest version of Borsa Italiana's Corporate Governance Code, whereby the Internal Control and Corporate Governance Committee is charged with additional tasks, including:

expressing its opinion on the proposal for appointing, removing and assigning duties to the person responsible for preparing the Company's financial reports,

assessing, together with the person responsible for preparing the Company's financial reports, whether the accounting policies have been correctly applied in preparing consolidated financial statements,

in cases of substitution of an independent director, proposing candidates for co-optation to the Board of directors,

defining the procedures and timing for conducting the board performance evaluation .

According to the Company's Self Regulatory Code, the Committee is composed of independent directors. The Committee in charge until April 16, 2007, was appointed on May 6, 2004 and comprised Guido Ferrarini (Chairman of the Committee), Francesco Denozza, Domenico De Sole and Marco Onado. The present Internal Control and Corporate Governance Committee was appointed by the Board of Directors on May 8, 2007 and is composed of: Paolo Baratta (Chairman of the Committee), Diana Bracco, Domenico De Sole, Luigi Fausti and Cesare Giovanni Vecchio.

During 2006 the Committee contributed to the implementation of the Company's instruments of corporate governance and participated in the process of their updating. Moreover the Committee monitored the introduction of IAS/IFRS for the financial statements of the Group and the Company and kept abreast of the progress made by the so called 404 Project, aimed at ensuring timely and correct compliance by the Company with the disclosure requirements set forth by Section 404 of the Sarbanes-Oxley Act. As well as monitoring transactions that the Board deemed especially delicate, the Committee examined and approved the basic elements of the internal audit plan for 2007 and periodically assessed the work of Telecom Italia Audit & Compliance Services.

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In 2006, the Committee held 15 meetings, with an attendance rate of 95%. Committee meetings were attended by the Chairman of the Board of Auditors or by the auditor he designated; where it was deemed desirable in the light of the issues on the agenda, the Committee and the Board of Auditors held joint meetings. In particular, the Committee met on a number of occasions with the Board of Auditors to consider actions to be taken with respect to:

- events relating to the ex head of the Security Function within the Company Giuliano Tavaroli,
- network security and services provided to the Judicial Authorities in Italy by the Company in accordance with legal obligations applicable to all telecommunication operators in Italy, and
- issues that arose, including responding to an order of the Italian Privacy Authority, with respect to traffic data, privacy and the collection of information on employees.

Such issues were considered of such importance that the Committee prepared an ad-hoc report describing the procedures and actions taken by the Company, the Committee and the Board of Directors since mid-2005 through February 2007 with respect to them. A full copy of the report was filed with the SEC by the Company on a Form 6-K dated February 22, 2007. The report included in the Form 6-K is an unofficial English translation of the report prepared in Italian by the Committee. In the event of conflict or inconsistency between the terms used in the

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Italian version of the report and the English translation, the Italian version shall prevail, as the official document is the Italian version.

***Remuneration Committee***

The Remuneration Committee is basically charged with submitting proposals to the Board of directors for the remuneration of the Managing Directors and the directors entrusted with special tasks, and is responsible for assessing the criteria for the remuneration of the Company's top management. To perform these duties, the Committee may use the structures of the Company as well as external consultants.

The Committee in charge until April 16, 2007 was appointed on May 6, 2004 and was composed by Luigi Fausti (Chairman of the Committee), Paolo Baratta and Pasquale Pistorio. The present Remuneration Committee was appointed on May, 8, 2007 and is composed solely by independent directors: Stefano Cao, Renzo Capra, Luigi Fausti e Luigi Zingales.

In 2006 the Committee met five times with an average attendance rate of more than 93%.

For more information concerning the remuneration of directors and top management see Item 6. Directors, Senior Management and Employees 6.6 Compensation of Directors, Officers and Members of the Board of Auditors .

**Internal Control System**

The Company's internal control system is conceived as a process made up of rules, procedures and organizational structures for the achievement of substantial and procedural fairness, transparency and accountability, the values laid down by the Code of Ethics. The aim of the system is to ensure that corporate operations are efficient and can be known and verified, that accounting and operational data are reliable, that applicable laws and regulations are complied with, and that the assets of the business are safeguarded, not least with a view to preventing the perpetration of fraud against the Company and the financial market.

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

- separation of roles in the performance of the activities involved in each operating process;
- traceability and constant visibility of decisions, so that responsibility can be pinpointed and the rationale of the actions performed can be identified; and



- decision-making on an objective basis, so that purely subjective considerations are set aside and decisions are taken according to criteria that are established in advance and can be verified.

The Board of Directors is responsible for the internal control system. It establishes the guidelines for the system and verifies that it is adequate and works effectively, making sure that the main operational, regulatory, economic and financial risks are appropriately identified and managed. To verify the correct operation of the internal control system the Board uses the Internal Control and Corporate Governance Committee and a suitably independent entity which has sufficient resources to perform the internal control function (presently, the Consortium company Telecom Italia Audit & Compliance Services).

The Executive Deputy Chairman Carlo Orazio Buora is charged with the task of determining the mechanisms of the system and the manner in which it is to be implemented in accordance with the guidelines established by the Board; he is also responsible for ensuring the system's overall adequacy, its effectiveness and its adaptation to changes in operating conditions and the legislative and regulatory framework. In particular, he is responsible for the identification, monitoring and management of corporate risks, which he submits for evaluation to the Board of Directors.

The entity is responsible for the internal control system and is entrusted with the task of verifying the adequacy and effectiveness of the system and, where deficiencies are found, to propose appropriate remedies. To this end the Board appointed the Company's internal auditor (the Consortium company Telecom Italia Audit & Compliance Services). The consortium company through its Chairman, whom Telecom Italia nominates reports on its

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activity to the Internal Control & Corporate Governance Committee, the Board of Auditors and the Executive Deputy Chairman, who is the director in charge of the internal control system. The aim of entrusting the internal auditing function to a consortium company (in which TI Media also holds an interest) is to maximize the independence of the person responsible for internal control from Telecom Italia's corporate structures.

In 2005 the position of Group Compliance Officer was created to coordinate the implementation of the Group's internal control system. The Group Compliance Officer performs a role of coordination of the various plans for the improvement of the Group's internal control system and is responsible for monitoring and facilitating the relationship between the Company's management and the internal auditor, so as to guarantee, with the assistance of Telecom Italia Audit & Compliance Services, methodological correctness in the management of risks. Furthermore, to ensure coordination of risk management at the top level, in 2006 a specific Risk Management Committee, chaired by the Executive Deputy Chairman, was established.

As regards compliance with the provisions implementing the Sarbanes-Oxley Act, in 2006 the Group followed through on its 404 Project which commenced in the second quarter of 2005. It involved the whole Group under the guidance at top level of a specific Steering Committee, composed of the Managing Directors of Telecom Italia (after September 16, 2006: the Executive Deputy Chairman and the Managing Director), the Group's Chief Financial Officer, the General Counsel and the managers in charge of Media and Olivetti.

As per applicable Italian law, the shareholders' meeting on April 16, 2007, introduced into the Company's Bylaws, the position of person responsible for preparing the Company's financial reports. The bylaws specifies the experience requirements (in the fields of administration, finance and auditing) for this new position, and the Board of Directors is in charge of appointing (and removing) this officer after consulting with the Board of Auditors and to determine the powers and duties of the office.

The Telecom Italia Group's internal control system is completed by an *ad hoc* organizational model (the so called 231 Organizational Model) that goes beyond the mere application of the provisions of Legislative Decree No. 231/2001, since it provides a paradigm for the conduct of all those who act in the Company's name and on its behalf. More specifically, the model comprises principles for dealings with governmental bodies (elaborated as a set of rules for relations with representatives of such bodies) and internal control checklists listing: (i) the main stages of every process, (ii) the offences that may be committed in relation to individual processes, and (iii) the control activities to prevent the related risks. The organizational model is reviewed periodically. In 2006 some modifications were necessary to adapt the model to changes in the relevant legislation, while other modifications were deemed appropriate in the light of experience in the application of the model. In addition, through the 231 Steering Committee, the Company checked the adequacy of the internal control system with respect to new types of offenses, with special reference to the market abuse.

The functioning of the model and compliance with it are monitored by a Supervisory Panel composed of a member of the Board of Auditors, an independent director and the person responsible for the internal control system. The panel's composition thus embraces all the professional skills involved in the control of operations and is aimed to ensure the body's independence. The Supervisory Panel reports to the Board of Directors, the Committee for Internal Control and Corporate Governance and the Board of Auditors on the checks performed and their results. A special unit has been created within Telecom Italia Audit & Compliance Services to provide operational support to the Supervisory Panels by handling reports of violations of the organizational model and conducting compliance audits on the basis of the data received through the information flows that have been put in place.

**Board of Auditors**

***Tasks and role***

The Board of Auditors verifies the observance of the law and the Bylaws and verifies the observance of the best administration principles, the adequacy and reliability of corporate structures, internal audit procedures and accounting system, and the adequacy of instructions given by the Company to its subsidiaries. The Board of Auditors must receive timely disclosures, at least on a quarterly basis, from the Board of Directors about the company's business and significant transactions performed by the company and its subsidiaries, including related parties transactions. Statutory Auditors must inform the CONSOB of any irregularity they detect in the course of

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their duties and are required to attend Shareholders Meetings, Board of Directors meetings and Executive Committee meetings (in case such Committee is established).

In order to make available the broad range of information needed by the Board of Auditors (if such Committee is established) to perform its control function effectively, the Company introduced the Procedure for Compliance with the Requirements of Article 150.1 of the Consolidated Law On Finance. This procedure has been recently incorporated by the Procedure for Information to Directors and Auditors.

The Board of Auditors held 32 meetings during 2006 (some jointly with the Internal Control and Corporate Governance Committee), with an attendance rate of 92%. In addition, its members participated in the meetings of the Board of Directors and periodically received the reports from the executive directors, as provided in the above mentioned procedure.

In addition to the tasks performed while acting in lieu of the Audit Committee (see below), in 2006 the Board of Auditors carried out supervisory functions provided for under Italian law: verifying that the transactions of greatest significance for the Company's profitability, financial position and assets and liabilities conformed with the law, the bylaws and the principles of correct management; checking that transactions with related parties complied with the self-regulatory principles and procedures adopted by the Company and that they were in its interest; and checking the adequacy of the organizational structure. The Board of Auditors also monitored the adequacy of the internal control system and that of the administrative and accounting system and the latter's reliability in correctly representing transactions. In particular, during 2006, the adequacy of organizational structure and the internal control system has been subject matter of evaluation by the Board of Auditors (which met several times jointly with the Internal Control and Corporate Governance Committee), in connection with problems concerning the Group's Security Function, network security and handling of traffic data. Lastly, the Board investigated the reports it received under Article 2408 of the Italian Civil Code and the complaints submitted to it as Audit Committee (see below the description of the ad-hoc procedure it adopted to this end).

**Appointment**

Telecom Italia's Board of Auditors is composed of five regular auditors, and two alternate auditors. Pursuant to Article 17 of Telecom Italia's Bylaws the Board of Auditors is appointed by the Shareholders Meeting through the slate system under the same procedure used for the election of the Board of Directors. Three regular auditors and one alternate auditor are drawn from the so called majority slate (that is a slate that obtained the majority of the votes cast by the shareholders), two regular auditors are taken from the other slates, so called minority slates. One alternate auditor is drawn from the minority slate which has obtained the largest number of votes.

In case an auditor chosen from the majority slate or one of the minority slates ceases from office, the alternate chosen respectively from the majority slate or the minority slate takes his/her place, until the next Shareholders Meeting, which will appoint a replacement. Pursuant to article 148 of the Consolidated Law on Finance (as amended by the legislation on protection of savings), the Chairman of the Board of Auditors is appointed by the shareholders meeting from among the auditors elected from a minority slate.

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

The present Board of Auditors was elected, for a three year term, by the shareholders meeting of April 13, 2006, on the basis of two slates presented respectively by Olimpia (Telecom Italia's largest shareholder) and by minority shareholders. Salvatore Spiniello, Ferdinando Superti Furga and Gianfranco Zanda were elected from the majority slate, while Paolo Golia and Stefano Meroi were elected from the minority slate. Paolo Golia was appointed, by the shareholders meeting, as Chairman of the Board. Following the resignation of one of the two minority members, Stefano Meroi, on October 20, 2006, the alternate director elected from the minority slate, Enrico Maria Bignami, took the office until the shareholders meeting of April 16, 2007, which formally appointed him. The same meeting appointed a new alternate auditor, in the person of Luigi Gaspari, who was designated by the same shareholders who had submitted the slate from which Stefano Meroi e Enrico Maria Bignami were elected.

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As described above, the Board of Auditors plays a key role in the Company's system of corporate governance. This is confirmed not only by the number of meetings in 2006 (32 meetings of which some, as mentioned earlier, were held jointly with the Committee for Internal Control and Corporate Governance) but also by the Company's choices relating to US law.

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

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

As concerns the appointment and retention of the external auditor, in 2003 the Telecom Italia Group introduced a procedure that made the choices of the Directors subject to the corroborating opinion of the Board of Auditors (the procedure is available on the Company's website, under "Governance"). Pursuant to the legislation on protection of savings, at present, the Board of Auditors is directly called to submit the proposal for the appointment of the external auditor directly to the shareholders' meeting. Consequently, the Board of Auditors submitted its proposal concerning the appointment of the external auditor to shareholders meeting of April 16, 2007.

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

- statements of violations submitted by shareholders concerning matters deemed to be improper;
- complaints by any person, thus including non-shareholders, concerning alleged irregularities, improper facts or, more generally, any problem or issue deemed to merit investigation by the control body;
- complaints specifically regarding accounting, internal accounting controls, or auditing matters;
- confidential, possibly anonymous submissions of concerns by employees of the Company or the Group regarding questionable accounting or auditing matters.

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

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

Shareholders Meetings are called by the Company s Board of Directors when required by law or the shareholders or deemed necessary.

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

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

Shareholders are informed of all Shareholders Meetings to be held by publication of a notice in *Gazzetta Ufficiale della Repubblica Italiana* at least 30 days before the date fixed for the meeting. In the case of a Shareholders Meeting that is called at the request of the minority shareholders or a Shareholders Meeting called to approve the liquidation of the Company, the notice period is reduced to 20 days. The notice period is reduced to 15 days if the Company is subject to a tender offer and a Shareholders Meeting is called to consider defensive actions against such tender offer (in which case resolutions must be approved by at least 30% of the holders of the voting shares outstanding at all calls of the Shareholders Meeting). The notice must also be published in at least one national daily newspaper. The notice of a Shareholders Meeting may specify up to two meeting dates for an ordinary Shareholders Meeting and up to three meeting dates for an extraordinary Shareholders Meeting ( calls ).

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



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

To attend any Shareholders Meeting, an ad hoc communication by the authorized intermediary must have been received by the Company at least two days before the meeting takes place. The communication procedure does not involve any blocking of the so called deposited shares: no transfer is required and the shares may be withdrawn at any time. In case of the shares withdrawal, their prior deposit becomes ineffective for purposes of attending the meeting.

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

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As a rule, votes cast in the Shareholders Meeting are open, as the minutes of the meeting are required to evidence how attending shareholders voted.

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

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

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

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

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

Shareholders representing at least 2.5% of the share capital may request, within five days of the publication of the notice convening the meeting, additions to the agenda, specifying in the request the additional items they propose. Additions to the agenda may not be made for matters on which the shareholders meeting is required by law to resolve on proposals put forward by the directors or on the basis of a plan or report by the Board of Directors. Notice of items added to the agenda following requests by shareholders, as above, shall be given in the same forms prescribed for the publication of the notice convening the meeting. The shareholders

power to request additions to the agenda is now formally regulated by an ad-hoc amendment to Article 18 of the Bylaws, approved by the shareholders meeting of April 16, 2007.

The Shareholders Meeting on May 6, 2004 adopted a set of Rules of Proceeding, which apply to both Ordinary and Extraordinary meetings, which has been amended by the shareholders Meeting of April 16, 2007, in order to conform to the legislation on the protection of savings. The new version of the Rules requires shareholders requesting additions to the agenda of the shareholders meeting to present an ad-hoc report describing their proposal.

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

The Joint Representative, who is appointed by the Special Meeting or, in default, by the Court, is entitled (i) to inspect certain corporate books of the Company, (ii) to attend the Shareholders Meetings and (iii) to challenge in court the resolutions adopted by such meetings. The Joint Representative is appointed for a maximum three-year term and, according to the Bylaws, is kept informed by the Company regarding corporate events that can affect the price trend of Savings Shares. The Savings Shareholders Meeting held on May 16, 2007 reappointed Mr. Carlo Pasteris as joint Representative for a three year period.

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

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

**Disclosure**

Transparent relations with the financial markets, and the provision of accurate, clear and complete information are standards for the conduct of the members of the governing bodies, the management and all the employees of the Telecom Italia Group. Specific procedures are used for classifying and managing information from a standpoint of confidentiality.

The procedure for disclosing price-sensitive information adopted in 2002 (Procedure for the Disclosure of Price-sensitive Information) was replaced pursuant to a resolution of the Board of Directors on March 7, 2006, by a more comprehensive procedure for the disclosure of inside information, as the result of activity of the working group the Company set up to evaluate the effects of the transposition into Italian law of the EU's Market Abuse Directive.

The procedure (posted on the Company's website under "Governance") covers the handling including the public disclosure of inside information concerning Telecom Italia, its unlisted subsidiaries and listed financial instruments, and is addressed to all the members of the governing bodies, employees and outside consultants of Group companies who have potential access to inside information. It also applies as an instruction to all subsidiaries for the purpose of promptly obtaining the necessary information for timely and correct compliance with public disclosure requirements. The procedure also governs the register of persons with access to inside information, which has been operational since April 1, 2006.

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

- the requirements and responsibility for the classification of inside information;
- the manner of tracing access to inside information being prepared, with special regard to the creation of the register required by Italian law;

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- the instruments and rules for safeguarding inside information in the making;
- the operational rules for the disclosure of inside information to the market and in general for public announcements and/or communications to analysts/investors.

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

- to assist the Board in the preparation of corporate communications (including preparation of the Annual Report on Form 20-F), the Senior Officers (as defined below) in the certification of the Annual Report of Form 20-F filed with the SEC in accordance with the Sarbanes-Oxley Act, and the director appointed to handle price-sensitive information;
- to monitor the application of procedures and controls for the collection, analysis and retention of data and information for publication and filing, verify their adequacy and effectiveness and propose corrective measures where appropriate; and
- to supervise the structure and updating of the Company's website as regards its institutional contents.

The role and operating rules of the Disclosure Committee (which are posted on the Company's website under Governance), have been revised as part of a process of updating the Company's different mechanisms of corporate governance, so that the Disclosure Committee is now focused on validating, monitoring and checking the effectiveness of the procedures and controls used for gathering, analyzing, retaining and processing the data and information to be transmitted to Directors and Statutory Auditors on the one hand and to be disclosed to the market on the other.

*With reference to the preparation of the Annual Report, the Committee, which had sponsored the 404 Project, examined the Procedure for the Preparation of the Telecom Italia 2006 Annual Report (Form 20-F). In this connection, a specific mechanism of upward attestation by the people in charge of the various corporate structures involved in the process of gathering and handling data and drafting the document was set up to give adequate assurance to and support the senior officers, the Board of Auditors, the Internal control and Corporate Governance Committee and the Board of Directors as a whole in fulfilling their responsibility for oversight of the accuracy and timeliness of required disclosures.*

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Exchange Controls And Other Limitations Affecting Security Holders

**10.2 EXCHANGE CONTROLS AND OTHER LIMITATIONS AFFECTING SECURITY HOLDERS****Foreign Investment and Exchange Control Regulations in Italy**

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

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

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

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





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**Description Of Bylaws**

**10.3 DESCRIPTION OF BYLAWS**

***Object***

Telecom Italia s objects are described in Article 3 of the Bylaws. Such objects are:

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

***Directors***

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

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

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

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

***Recent amendments***

The shareholders' meeting held on April 16, 2007 approved a series of amendments to the Bylaws to adapt it to the provisions of Law 262/2005 (the so-called Law on the Protection of Savings), as amended by Legislative Decree 303/2006. Some amendments also responded to the recommendations and criteria set forth by the Italian Stock Exchange new Corporate Governance Code (March 2006 edition).

In brief:

the amendments to the Company's object (Article 3) updated the description of the Company's goals (dating back to 1997 in its formulation). The formal revision of the clause therefore was aimed at clarifying and modernizing a text that had become obsolete;

rules were introduced concerning the organization of savings shareholders (Article 6) and bondholders (Article 8). In both cases the principle was introduced that the Company should bear the related organizational costs, within different limits;

various changes were passed to the provisions on the Board of Directors (Article 9), some serving merely to clarify or simplify the text, while others to adapt the provisions to the new legislative and regulatory framework. Corresponding amendments were approved with reference to the Board of Auditors (Article 17);

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the provisions concerning corporate offices (Article 10) was revised and the possibility of appointing more than one Deputy Chairman was introduced;

as established by law, the Board was entrusted with appointing the manager responsible for the preparation of the Company's financial reports (Article 13);

the articles concerning the shareholders' meetings (Articles 18 and 20) were modified in order both to adapt them to the new legislative provisions and to clarify and simplify their formulation.

For a description of the new set of rules, please See 10.1 Corporate Governance .

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As of April 18, 2007, the subscribed and fully paid-up capital stock was equal to 10,673,776,696.55 divided into 13,380,746,060 Ordinary Shares and 6,026,120,661 Savings Shares, each with a par value of 0.55.

The Shareholders Meeting of May 26, 2003, reiterating, updating and, where necessary, renewing earlier resolutions of the Shareholders Meeting and the Board of Directors resolved to increase the share capital by up to a maximum of 624,936,779.50 (at April 18, 2007 125,771,565.15), by means of the issue of up to a maximum of 1,136,248,690 (at April 18, 2007 228,675,573).

Ordinary Shares with a par value of 0.55 each to be reserved irrevocably and exclusively for the conversion of the Olivetti 1.5% 2001-2010 convertible notes with redemption premium (now Telecom Italia 1.5% 2001-2010 convertible notes with redemption premium ) convertible bonds, on the basis of 0.471553 Ordinary Shares for each bond presented for conversion.

The Shareholders Meeting of May 26, 2003 also resolved to increase the share capital by up to a maximum of 183,386,986.75 (at April 18, 2007 55,307,528.10), by means of the issue of up to a maximum of 333,430,885 (at April 18, 2007 100,559,142).

Ordinary Shares with a par value of 0.55 each, divided into the following outstanding divisible tranches:

- a tranche of up to a maximum of 37,398,868.65 (at April 18, 2007 9,712,784.40) for the exercise of the Piano di Stock Option 2000 stock options, increase to be implemented by July 30, 2008 by means of the issue of up to a maximum of 67,997,943 (at April 18, 2007 17,659,608) shares with a par value of 0.55 each, to be subscribed for at a total price of 13.815 per option held (i.e. at a price of 4.185259 for each newly-issued share);
- a tranche of up to a maximum of 21,422,652.90 (at April 18, 2007 16,484,542.80) for the exercise of the Piano di Stock Option Top 2002 stock options, increase to be implemented by February 28, 2010 by means of the issue of up to a maximum of 38,950,278 (at April 18, 2007 29,971,896) shares with a par value of 0.55 each, to be subscribed for at a total price of 9.203 per option held (i.e. at a price of 2.788052 for each newly-issued share);
- a tranche of up to a maximum of 50,268,799.90 (at April 18, 2007 29,110,200.90) for the exercise of the Piano di Stock Option 2002 stock options, increase to be implemented by March 31, 2008 for the first lot, by March 31, 2009 for the second lot and by March 31, 2010 for the third lot by means of the issue of up to a maximum of 91,397,818 (at April 18, 2007 52,927,638) shares with a par value of 0.55 each, to be subscribed for at a total price for the different options of respectively 9.665, 7.952 and 7.721 per option held (i.e. at a price for the different options of respectively 2.928015, 2.409061 and 2.339080 for each newly-issued share).

The Shareholders Meeting held on April 7, 2005 resolved to increase the share capital by up to a maximum of 38,655,832.60 (at April 18, 2007 27,304,720.30), by means of the issue of up to a maximum of 70,283,332 (at April 18, 2007 49,644,946) Ordinary Shares with a par value of 0.55 each, divided into the following outstanding divisible tranches:

1. a tranche of up to a maximum of 11,705,656.05 (at April 18, 2007 9,320,515.05) for the exercise of the 2000- 2002 Stock-Option Plans stock options, increase to be implemented by December 31, 2008 by means of the issue of up to 21,283,011 (at April 18, 2007 16,946,391) Telecom Italia Ordinary Shares with a par value of 0.55 each, to be subscribed for at a total price of 6.42 per option held (i.e. at a price of 3.710983 for each newly-issued share);
2. a tranche of up to a maximum of 22,150,920 (at April 18, 2007 16,380,072.50) for the exercise of the 2002-2003 Stock-Option Plans stock options, increase to be implemented by December 31, 2008 by means of the issue of up to 40,274,400 (at April 18, 2007 29,781,950) Telecom Italia Ordinary Shares with a par value of 0.55 each, to be subscribed for at a total price of 5.67 per option held (i.e. at a price of 3.277457 for each newly-issued share);

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3. a tranche of up to a maximum of 3,192,173.05 (at April 18, 2007 1,604,132.75) for the exercise of the 2003-2005 Stock-Option Plans stock options, increase to be implemented by December 31, 2008 for the first lot, by December 31, 2009 for the second lot and by December 31, 2010 for the third lot by means of the issue of up to a maximum of 5,803,951 (at April 18, 2007 2,916,605) Telecom Italia Ordinary Shares with a par value of 0.55 each, to be subscribed for at a total price of 5.07 per option held (i.e. at a price of 2.930636 for each newly-issued share).

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

- (i) to be offered with the right of pre-emption to shareholders and holders of convertible bonds; or
- (ii) to be offered for subscription to employees of Telecom Italia S.p.A. or its subsidiaries, with the exclusion of the right of pre-emption, provided such increase in capital does not exceed 1% of the capital attested at the date of the offering, pursuant to the combined effects of Article 2441, last paragraph, of the Civil Code and Articles 134(2) of Legislative Decree 58/1998.

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

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

***Classes of shares***

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

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

***Form and Transfer***

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

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

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

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

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

***Dividend Rights***

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

In case the net income is insufficient, the Annual Ordinary Shareholders' meeting is allowed to satisfy the aforementioned preferential rights by distributing reserves, when available.

***Subscription Rights***

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

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

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

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



***Liquidation Rights***

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

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

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

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

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

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

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

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

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

As of June 13, 2007, Telecom Italia owns 1,272,014 of its own Ordinary Shares.

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

when the resolution was taken.

The Shareholders Meeting of April 16, 2007 revoked the aforementioned authorizations for the purchase and disposal of treasury shares, while authorizing, for an 18-month period, the purchase, on one or more occasions and at any time, of up to a maximum of 25,000,000 Ordinary Shares, servicing a plan for the award of free Telecom Italia S.p.A. Ordinary Shares aimed at members of the top management of the Group, to be selected by the Board of Directors. According to the resolution the purchase price must lie between a minimum and a maximum corresponding to the weighted average of the official prices of Ordinary Shares recorded by Borsa Italiana on the ten trading days prior to the date of the purchase, respectively decreased and increased by 10%. The purchases must be made on regulated markets and according to the procedures allowed by the statutory and regulatory provisions in force.

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

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

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

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

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

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

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

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

***Limitations on Voting and Shareholdings***

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

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

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

**Deposit, Issuance, Transfer and Withdrawal**

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

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

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

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

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

**Distributions on Deposited Securities**

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



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

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

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

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

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

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

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

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

**Disclosure of Interests**

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

**Record Dates**

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

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

**Voting of Deposited Securities**

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

**Charges of Depositary**

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

**Liability of Holders for Taxes**



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

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

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

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

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

**General Limitations**

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

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

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

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

**Governing Law**

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

**JPMorgan Chase Bank**

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

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

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

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



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**10.6 TAXATION**

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

**Italian Taxation**

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

***Income Tax***

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

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

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

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

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

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

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

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

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

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

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

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

**Transfer Tax**

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

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



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

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

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

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

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

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

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

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

***Inheritance and Gift Tax***

Pursuant to Law Decree No. 262 of October 3, 2006, converted with amendments into Law No. 286 of November 24, 2006, effective from November 29, 2006, and Law No. 296 of December 27, 2006, the transfers of any valuable asset (including Shares, Savings Shares and ADRs) as a result of death or donation (or other transfers for no consideration) and the creation of liens on such assets for a specific purpose are taxed as follows:

- (i) transfers in favour of the spouse and of direct descendants or ascendants are subject to an inheritance and gift tax applied at a rate of 4% on the value of the inheritance or the gift exceeding 1,000,000 (per beneficiary);
- (ii) transfers in favour of the brothers and sisters are subject to an inheritance and gift tax applied at a rate of 6% on the value of the inheritance or the gift exceeding 100,000 (per beneficiary). The same tax rate applies in favour of handicapped individuals on the value of inheritance or gift exceeding 1,500,000 (per beneficiary);
- (iii) transfers in favour of all other relatives up to the fourth degree or relatives-in-law up to the third degree, are subject to an inheritance and gift tax applied at a rate of 6% on the entire value of the inheritance or the gift;
- (iv) any other transfer is subject to an inheritance and gift tax applied at a rate of 8% on the entire value of the inheritance or the gift.

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With respect to listed Shares, the value for inheritance and gift tax purposes is the average stock exchange price of the last quarter preceding the date of the succession or of the gift (increased by the interest accrued meanwhile). With respect to unlisted Shares, the value for inheritance and gift tax purposes is determined by reference to the value of listed debt securities having similar features or based on other certain elements.

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

### **United States Federal Income Taxation**

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

- a citizen or resident of the United States;

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

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

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

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

- partnerships and other entities classified as partnerships for U.S. federal income tax purposes;
- persons subject to the alternative minimum tax;
- tax-exempt entities;
- dealers and traders in securities or foreign currencies;
- insurance companies;
- financial institutions;
- persons who own the Telecom Italia Shares or ADRs as part of an integrated investment, including a straddle, hedging or conversion transaction, comprised of the Telecom Italia Shares or ADRs and one or more other positions for tax purposes;

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- persons whose functional currency is not the U.S. dollar for U.S. federal income tax purposes;
- persons who actually or constructively own 10% or more of the Company's voting stock; or
- persons who acquire Telecom Italia Shares or ADRs pursuant to the exercise of any employee stock option or otherwise as compensation.

Please consult your tax advisor with regard to the application of U.S. federal income tax laws to the Telecom Italia Shares or ADRs, and any tax consequences arising under the laws of any state, local or non-U.S. taxing jurisdiction. For U.S. federal income tax purposes, holders of ADRs evidencing American Depositary Shares will generally be treated as owners of the underlying Shares or Savings Shares, as the case may be, represented by those American Depositary Shares. Accordingly, no gain or loss will be recognized if you exchange ADRs for the underlying shares represented by those ADRs.

This discussion assumes that the Company was not a passive foreign investment company for 2006 (as discussed below).

### ***Taxation of dividends***

Distributions made with respect to the Telecom Italia Shares or ADRs (other than certain pro rata distributions of Telecom Italia Shares or ADRs), including any Italian tax withheld, will generally constitute foreign source dividend income for U.S. federal income tax purposes to the extent such distributions are made from the Company's current or accumulated earnings and profits, as determined in accordance with U.S. federal income tax principles. Since the Company does not maintain calculations of earnings and profits under U.S. federal income tax principles, distributions will generally be reported to U.S. holders as dividends. Subject to applicable limitations that may vary depending on a U.S. holder's individual circumstances and the discussion above

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regarding concerns expressed by the U.S. Treasury, under current law, dividends paid to certain non-corporate U.S. holders in taxable years beginning before January 1, 2011 will be taxable at a maximum tax rate of 15%. Non-corporate U.S. holders should consult their own tax advisors to determine whether they are subject to any special rules that may limit their ability to be taxed at this favorable rate.

You will not be entitled to claim a dividends-received deduction for dividends paid on the Telecom Italia Shares or ADRs. The amount of any cash distribution paid in euros, including the amount of any Italian tax withheld, will be equal to the U.S. dollar value of such euros on the date of receipt by the Depository in the case of U.S. holders of ADRs, or by the U.S. holder in the case of U.S. holders of Telecom Italia Shares, regardless of whether the payment is in fact converted into U.S. dollars. Gain or loss, if any, recognized on the sale or other disposition of such euros will be U.S. source ordinary income or loss. If the dividend is converted into U.S. dollars on the date of receipt, by the Depository you generally should not be required to recognize foreign currency gain or loss in respect of the dividend income. You may have foreign currency gain or loss if the amount of such dividend is not converted into U.S. dollars on the date of its receipt. The amount of any distribution of property other than cash will be the fair market value of such property on the date of distribution.

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

***Taxation of capital gains***

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

***Passive Foreign Investment Company Rules***

The Company believes that it was not a passive foreign investment company ( PFIC ) for U.S. federal income tax purposes for 2006 and does not expect to be considered a PFIC in the foreseeable future. However, since PFIC status depends upon the composition of the Company's income and assets and the market value of the Company's assets (including, among others, less than 25% owned equity investments) from time to time, there can be no assurance that the Company will not be considered a PFIC for any taxable year. If the Company were treated as a PFIC for any taxable year during which a U.S. holder held Telecom Italia Shares or ADRs, certain adverse tax consequences could apply to the U.S. holder.

***Information Reporting and Backup Withholding***

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

- are a corporation or come within certain other exempt categories, and, when required, demonstrate this fact, or
- in the case of backup withholding, provide a correct taxpayer identification number, certify that you are not subject to backup withholding and otherwise comply with applicable requirements of the backup withholding rules.

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

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

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

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

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

Not applicable.

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

**PART II**

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

Not applicable.

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

**Use Of Proceeds**

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

Not applicable.

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**Item 15. Controls And Procedures**

**Disclosure Controls And Procedures**

**Item 15. CONTROLS AND PROCEDURES**

**15.1 DISCLOSURE CONTROLS AND PROCEDURES**

As of December 31, 2006, the Company, under the supervision and with the participation of the officers selected by the 404 Implementation Team (made up of managers from the Finance Administration and Control, the Human Resources, the Information Technology Governance and the legal departments, together with representatives of Telecom Italia Audit and Compliance Services), according to the guidelines set forth by the Steering Committee for the 404 Project (composed of the Executive Deputy Chairman and the Managing Director of Telecom Italia, the Group's Chief Financial Officer, the General Counsel and the managers in charge of Media and Olivetti), and Telecom Italia Audit and Compliance Services S.c.a.r.l. performed an evaluation of the effectiveness of the Company's disclosure controls and procedures. The Company's management necessarily applied its judgment in assessing the costs and benefits of such controls and procedures, which by their nature can provide only reasonable assurance regarding management's control objectives. Based on this evaluation, the Company's Executive Deputy Chairman and Chief Executive Officer and the Chief Financial Officer concluded that the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act) are effective at the reasonable assurance level.

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**Item 15. Controls And Procedures**

**Management's Annual Report On Internal Control Over Financial Reporting**

**15.2 MANAGEMENT'S ANNUAL REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting. Internal control over financial reporting is defined in Rule 13a-15(f) or 15d-15(f) promulgated under the Exchange Act as a process designed by, or under the supervision of, the company's Chief Executive Officer and Chief Financial Officer and effected by the Company's board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that:

pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transaction and dispositions of the assets of the company;

provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures for the company are being made only in accordance with authorizations of management and directors of the company; and

provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

The Company's management assessed the effectiveness of the company's internal control over financial reporting as of December 31, 2006. In making this assessment, the company's management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework.

Based on our assessment, management believes that, as of December 31, 2006, the Company's internal control over financial reporting is effective based on those criteria.

The company's independent auditors have issued an audit report on our assessment of the company's internal control over financial reporting. This report appears below.

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**Item 15. Controls And Procedures**

**Management's Annual Report On Internal Control Over Financial Reporting**

**Report of Independent Registered Public Accounting Firm**

**To the Board of Directors and Shareholders of Telecom Italia S.p.A.**

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting, that Telecom Italia S.p.A. maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Telecom Italia S.p.A.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.



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**Item 15. Controls And Procedures**

**Management's Annual Report On Internal Control Over Financial Reporting**

In our opinion, management's assessment that Telecom Italia S.p.A. maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, Telecom Italia S.p.A. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Telecom Italia S.p.A. as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2006 and our report dated March 26, 2007, except for notes 46, 47 and 48, as to which the date is June 15, 2007, expressed an unqualified opinion thereon.

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

Milan, Italy

March 26, 2007

except for internal control over financial reporting

related to notes 46, 47 and 48 as to which the date is

June 15, 2007



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**Item 15. Controls And Procedures**

**Changes in Internal Control Over Financial Reporting**

**15.3 CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING**

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

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

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

**Item 16. [RESERVED]**

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

After its reintegration as per the resolutions by the Shareholders Meeting of April 16, 2007, the Board of Auditors has determined that each of its members is an audit committee financial expert as defined in Item 16A of Form 20-F. For the names of the members of the Board of Auditors, See Item 10. Additional Information 10.1 Corporate Governance 10.1.2 General Board of Directors Board of Auditors .

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

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

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

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

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

The following table sets forth the aggregate fees for professional services and other services rendered by Ernst & Young in 2006 and 2005.

| <u>Type of Fees</u>   | <u>For the fiscal year ended<br/>December 31,</u> |               |
|-----------------------|---|---------------|
|                       | <u>2006</u>                                       | <u>2005</u>   |
|                       | <u>(thousands of Euro)</u>                        |               |
| Audit Fees(1)         | 11,381  | 13,434        |
| Audit-related Fees(2) | 795   | 843           |
| <b>Total</b>          | <b>12,176</b>                                     | <b>14,277</b> |

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

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

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

The Board of Auditors (also in its role as Telecom Italia's Audit Committee), in accordance with and to the extent permitted by applicable Italian law, is responsible for the appointment, retention and oversight of the work of the Company's external auditors engaged for the purpose of issuing the audit report on the annual financial statements. To this effect, the Board of Auditors makes a recommendation to the Shareholders' Meeting which appoints the external auditors and determines their compensation. The three-year period 2004-2006 audit engagement conferred to Reconta Ernst & Young S.p.A. by the Telecom Italia Shareholders' Meeting on May 6, 2004 came to an end with the issuance by Reconta Ernst & Young S.p.A. of its audit report on the financial statements of Telecom Italia for the year ended December 31, 2006. As a result of this and under the applicable Italian rules and regulations governing the appointment of independent auditors for listed companies, on April 16, 2007, the Telecom Italia

Shareholders Meeting resolved to extend the appointment of Reconta Ernst & Young S.p.A. as Telecom Italia's primary independent auditors for the three year period 2007-2009.

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

**Audit Services:**

1. Audit of annual and interim financial statements on the basis of applicable laws and regulations (including the audit of SEC registered companies' annual report).
2. Audit of annual and interim financial consolidated reporting packages.
3. Audit conformity of the Telecom Italia Group's sustainability reports or social reports.
4. Reports or opinions required by law for specific transactions from the auditor appointed to audit the annual financial statements, to the extent permitted.

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

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

**Permitted Non-audit Services:**

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

3. Assistance to the internal audit department within the limits imposed by SEC regulations.

The pre-approved services listed above are in all cases subject to scrutiny by the Director with delegated powers for internal controls, by the Board of Directors who may (by his own initiative or on request by the Committee for Internal Control and Corporate Governance or by the Board of Auditors) request supplementary documentation to verify the independent status of the auditor and take appropriate action if necessary.

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

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**Item 16D. Exemptions from the Listing Standards for Audit**

**Committees**

**Item 16E. Repurchases of Equity Securities**

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

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

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

From January 1, 2006, to December 31, 2006, no purchases were made by or on behalf of Telecom Italia or any affiliated purchaser of Shares or Savings Shares.

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**Item 17. Financial Statements**

**PART III**

**Item 17. FINANCIAL STATEMENTS**

Not applicable.

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**Item 18. Financial Statements**

**Item 19. Financial Statements and Exhibits**

**Item 18. FINANCIAL STATEMENTS**

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

**Item 19. FINANCIAL STATEMENTS AND EXHIBITS**

***(a) Financial Statements***

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***(b) Exhibits***

1.1 Bylaws of the Company (English Translation).

2.1 Deposit Agreements.

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

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

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2.2 Trust deed dated January 23, 2004, between Telecom Italia (as Issuer and Guarantor), Telecom Italia Finance (as Issuer) and J.P. Morgan Corporate Trustee Services Limited relating to a 10 billion Euro Medium Term Note Program. We hereby agree to furnish to the Commission, upon its request, a copy of any instrument defining the rights of holders of our long-term debt or that of our subsidiaries for which consolidated or unconsolidated financial statements are required to be filed.(3)

### 4.1 Public Telecommunications License.(4)

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

### 4.2 Stock Option Plans.

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

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

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

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

### 8.1 List of Subsidiaries.(7)

12(a) Certification by the Executive Deputy Chairman of Telecom Italia S.p.A., pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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**Item 19. Financial Statements and Exhibits**

12(b) Certification by the Chief Executive Officer of Telecom Italia S.p.A., pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

12(c) Certification by the Head of Finance, Administration and Control of Telecom Italia S.p.A., pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

13.1 Certification pursuant to 18 U.S.C Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

15.1 Report on Form 6-K dated February 22, 2007 (unofficial English translation of a report prepared by the Internal Control and Corporate Governance Committee of the Board of Directors of Telecom Italia S.p.A. for the Board of Directors). (8)

- 
- (1) Incorporated by reference to exhibit (a) filed with Olivetti s Registration Statement on Form F-6 filed with the SEC on July 18, 2003 (File No. 333-107144).
  - (2) Incorporated by reference to exhibit (a) filed with Olivetti s Registration Statement on Form F-6 filed with the SEC on July 18, 2003 (File No. 333-107142).
  - (3) Incorporated by reference to the Exhibits filed with the Company s Annual Report on Form 20-F on June 10, 2004 (File No. 001-13882).
  - (4) Incorporated by reference to the Exhibits filed with the Company s Annual Report on Form 20-F/A on June 29, 2001 (File No. 001-13882).
  - (5) Incorporated by reference to the Exhibits filed with the Company s Annual Report for the fiscal year ended December 31, 2002 on Form 20-F filed with the SEC on June 26, 2003 (File No. 001-13882).
  - (6) Incorporated by reference to the Exhibits filed with the Company s Annual Report on Form 20-F on June 10, 2004 (File No. 001-13882).
  - (7) Please see Note 45-List of Companies of the Telecom Italia Group of the Notes to the Consolidated Financial Statements included elsewhere herein.
  - (8) Incorporated by reference (File No. 001-13882).



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**Financial Statements**

**Report Of Independent Registered Public Accounting Firm**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Shareholders of Telecom Italia S.p.A.

We have audited the accompanying consolidated balance sheets of Telecom Italia S.p.A. (the Company) as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Telecom Italia S.p.A. at December 31, 2006 and 2005 and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 2006, in conformity with International Financial Reporting Standards as adopted by the European Union.

International Financial Reporting Standards as adopted by the European Union vary in certain significant respects from accounting principles generally accepted in the United States of America. Information relating to the nature and effect of such differences is presented in Notes 46, 47 and 48 to the financial statements.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Telecom Italia S.p.A.'s internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 26 and June 15, 2007 expressed an unqualified opinion thereon.

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

Milan, Italy

March 26, 2007

except for notes 46, 47 and 48 as to which the date is

June 15, 2007

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Financial Statements

Consolidated Balance Sheets

**CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2006 AND 2005 ASSETS**

|  | Note | As of December 31,   |                      |
|--|------|----------------------|----------------------|
|  |      | 2006                 | 2005                 |
|  |      | (millions of Euro)   |                      |
| <b>NON-CURRENT ASSETS</b>  |      |                      |                      |
| <b>Intangible assets</b>   |      |                      |                      |
| Goodwill   | 5    | 43,739               | 43,980               |
| Intangible assets with a finite life   | 6    | 6,740                | 6,810                |
|  |      | <u>50,479</u>        | <u>50,790</u>        |
| <b>Tangible assets</b>   |      |                      |                      |
| Property, plant and equipment owned  | 7    | 15,690               | 16,443               |
| Assets held under finance leases   | 7    | 1,525                | 1,598                |
|  |      | <u>17,215</u>        | <u>18,041</u>        |
| <b>Other non-current assets</b>  |      |                      |                      |
| Investments in associates and joint ventures accounted for using the equity method | 8    | 488                  | 781                  |
| Other investments  | 8    | 776                  | 561                  |
| Securities, financial receivables and other non-current financial assets           | 8    | 691                  | 996                  |
| Miscellaneous receivables and other non-current assets                             | 8    | 871                  | 825                  |
| Deferred tax assets  | 9    | 912                  | 2,793                |
|  |      | <u>3,738</u>         | <u>5,956</u>         |
| <b>TOTAL NON-CURRENT ASSETS (A)</b>  |      | <u><b>71,432</b></u> | <u><b>74,787</b></u> |
| <b>CURRENT ASSETS</b>  |      |                      |                      |
| Inventories  | 10   | 291                  | 294                  |
| Trade and miscellaneous receivables and other current assets                       | 11   | 8,748                | 8,856                |
| Current income tax receivables   | 12   | 287                  | 335                  |
| Securities   | 13   | 812                  | 378                  |
| Financial receivables and other current financial assets                           | 14   | 433                  | 509                  |
| Cash and cash equivalents  | 15   | 7,219                | 10,323               |
| <b>Current assets sub-total</b>  |      | <u><b>17,790</b></u> | <u><b>20,695</b></u> |
| <b>Discontinued operations/assets held for sale</b>                                |      |                      |                      |
| of a financial nature  |      |                      | 37                   |
| of a non-financial nature  |      | 235                  | 491                  |
|  | 16   | <u>235</u>           | <u>528</u>           |
| <b>TOTAL CURRENT ASSETS (B)</b>  |      | <u><b>18,025</b></u> | <u><b>21,223</b></u> |

|                           |               |               |
|---------------------------|---------------|---------------|
| <b>TOTAL ASSETS (A+B)</b> | <b>89,457</b> | <b>96,010</b> |
|---------------------------|---------------|---------------|

The accompanying notes are an integral part of these financial statements

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Financial Statements

Consolidated Balance Sheets

**CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2006 AND 2005****EQUITY AND LIABILITIES**

|   | Note | As of December 31, |               |
|---|------|--------------------|---------------|
|   |      | 2006               | 2005          |
|   |      | (millions of Euro) |               |
| <b>EQUITY</b>   |      |                    |               |
| Share capital issued  |      | 10,674             | 10,668        |
| Less: Treasury shares   |      | (69)               | (69)          |
| <b>Share Capital</b>  |      | <b>10,605</b>      | <b>10,599</b> |
| Reserve for additional paid-in capital  |      | 1,689              | 6,465         |
| Other reserves and retained earnings (accumulated losses), including net income (loss) for the year |      | 13,724             | 8,598         |
| <b>Equity attributable to equity holders of the Parent</b>  |      | <b>26,018</b>      | <b>25,662</b> |
| <b>Equity attributable to Minority Interests</b>  |      | <b>1,080</b>       | <b>1,323</b>  |
| <b>TOTAL EQUITY (A)</b>   | 17   | <b>27,098</b>      | <b>26,985</b> |
| <b>NON-CURRENT LIABILITIES</b>  |      |                    |               |
| Non-current financial liabilities   | 18   | 40,803             | 42,146        |
| Employee severance indemnities and other employee-related provisions                                | 19   | 1,262              | 1,351         |
| Deferred tax liabilities  | 9    | 194                | 137           |
| Provisions for risks and charges  | 20   | 775                | 797           |
| Miscellaneous payables and other non-current liabilities  | 21   | 1,857              | 2,113         |
| <b>TOTAL NON-CURRENT LIABILITIES (B)</b>  |      | <b>44,891</b>      | <b>46,544</b> |
| <b>CURRENT LIABILITIES</b>  |      |                    |               |
| Current financial liabilities   | 18   | 5,653              | 9,812         |
| Trade and miscellaneous payables and other current liabilities                                      | 22   | 11,596             | 12,157        |
| Current income tax payables   | 23   | 219                | 227           |
| <b>Current liabilities sub-total</b>  |      | <b>17,468</b>      | <b>22,196</b> |
| <b>Liabilities relating to discontinued operations/assets held for sale</b>                         |      |                    |               |
| of a financial nature   |      |                    | 143           |
| of a non-financial nature   |      |                    | 142           |
|   | 16   |                    | <b>285</b>    |
| <b>TOTAL CURRENT LIABILITIES (C)</b>  |      | <b>17,468</b>      | <b>22,481</b> |

|   |               |               |
|---|---------------|---------------|
| <b>TOTAL LIABILITIES (D=B+C)</b>          | <b>62,359</b> | <b>69,025</b> |
| <b>TOTAL EQUITY AND LIABILITIES (A+D)</b> | <b>89,457</b> | <b>96,010</b> |

The accompanying notes are an integral part of these financial statements

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Financial Statements

Consolidated Statements Of Income

**CONSOLIDATED STATEMENTS OF INCOME FOR THE YEARS ENDED****DECEMBER 31, 2006, 2005 AND 2004**

|  | Note | Year ended December 31, |               |               |
|--|------|-------------------------|---------------|---------------|
|  |      | 2006                    | 2005          | 2004          |
|  |      | (millions of Euro)      |               |               |
| Revenues   | 27   | 31,275                  | 29,919        | 28,292        |
| Other income   | 28   | 606                     | 678           | 1,099         |
| <b>Total operating revenues and other income</b>   |      | <b>31,881</b>           | <b>30,597</b> | <b>29,391</b> |
| Purchases of materials and external services   | 29   | (14,191)                | (12,937)      | (11,812)      |
| Personnel costs  | 30   | (3,801)                 | (4,142)       | (3,852)       |
| Other operating expenses   | 31   | (1,543)                 | (1,468)       | (1,603)       |
| Changes in inventories   | 10   | 8                       | (4)           | 27            |
| Capitalized internal construction costs  | 32   | 496                     | 471           | 713           |
| Depreciation and amortization  | 33   | (5,487)                 | (5,232)       | (4,808)       |
| Gains (losses) on disposals of non-current assets(1)   | 34   | 95                      | 242           | (9)           |
| Impairment reversals (losses) on non-current assets  | 35   | (21)                    | (28)          | (444)         |
| <b>Operating income</b>  |      | <b>7,437</b>            | <b>7,499</b>  | <b>7,603</b>  |
| Share of profits (losses) of associates and joint ventures accounted for using the equity method | 8    | 51                      | 23            | (5)           |
| Financial income   | 36   | 3,041                   | 3,144         | 2,224         |
| Financial expenses   | 37   | (5,014)                 | (5,131)       | (4,216)       |
| <b>Income from continuing operations before taxes</b>  |      | <b>5,515</b>            | <b>5,535</b>  | <b>5,606</b>  |
| Income taxes   | 38   | (2,519)                 | (2,395)       | (2,654)       |
| <b>Net income from continuing operations</b>   |      | <b>2,996</b>            | <b>3,140</b>  | <b>2,952</b>  |
| Net income (loss) from discontinued operations/assets held for sale                              | 16   | 7                       | 550           | (118)         |
| <b>Net income for the year</b>   |      | <b>3,003</b>            | <b>3,690</b>  | <b>2,834</b>  |
| <i>Of which:</i>   |      |                         |               |               |
| • <i>Net income attributable to equity holders of the Parent</i>                                 |      | <i>3,014</i>            | <i>3,216</i>  | <i>1,815</i>  |
| • <i>Net income (loss) attributable to Minority Interests</i>                                    |      | <i>(11)</i>             | <i>474</i>    | <i>1,019</i>  |

(1) Excludes capital gains/losses realized on disposals of investments classified as discontinued operations/assets held for sale and investments other than in subsidiaries.

Year ended December 31,

| 2006 | 2005 | 2004 |
|------|------|------|
|------|------|------|

|  | 39 | 0.15  | 0.17          | 0.11   |
|--|----|-------|---------------|--------|
| <b>Basic and Diluted Earnings Per Share (EPS)(*)</b>     |    |       | <b>(Euro)</b> |        |
| Ordinary Share   |    |       |               |        |
| Savings Share  |    | 0.16  | 0.18          | 0.12   |
| <i>Of which:</i>   |    |       |               |        |
| <i>From continuing operations</i>                        |    |       |               |        |
| Ordinary Share   |    | 0.15  | 0.14          | 0.12   |
| Savings Share  |    | 0.16  | 0.15          | 0.13   |
| <i>From discontinued operations/assets held for sale</i> |    |       |               |        |
| Ordinary Share   |    |       | 0.03          | (0.01) |
| Savings Share  |    |       | 0.03          | (0.01) |
|  |    | ————— | —————         | —————  |

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

The accompanying notes are an integral part of these financial statements

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Financial Statements

Consolidated Statement Of Changes In Equity

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004****Equity attributable to equity holders of the Parent**

|  | Share<br>capital | Reserve<br>for<br>additional<br>paid-in<br>capital | Reserve<br>for net<br>translation<br>differences | Other<br>reserves and<br>retained<br>earnings<br>(accumulated<br>losses),<br>including net<br>income (loss)<br>for the year | Total         | Equity<br>attributable<br>to Minority<br>Interests | Total<br>equity |
|--|------------------|--|--|---|---------------|--|-----------------|
| (millions of Euro)   |                  |  |  |   |               |  |                 |
| <b>Balance at December 31, 2003 in accordance with Italian GAAP</b>                      | <b>8,854</b>     | <b>88</b>  |  | <b>7,150</b>  | <b>16,092</b> | <b>4,497</b>                                       | <b>20,589</b>   |
| Adoption of IFRS   | (56)             | (56)   |  | 275   | 163           | 32   | 195             |
| <b>Balance at December 31, 2003 in accordance with IFRS</b>                              | <b>8,798</b>     | <b>32</b>  |  | <b>7,425</b>  | <b>16,255</b> | <b>4,529</b>                                       | <b>20,784</b>   |
| <b>Changes in equity in 2004:</b>  |                  |  |  |   |               |  |                 |
| Fair value adjustments of available-for-sale financial assets:                           |                  |  |  |   |               |  |                 |
| • Unrealized gains (losses) from fair value adjustments                                  |                  |  |  | 52  | 52            |  | 52              |
| • Gains/losses transferred to the statement of income                                    |                  |  |  | (9)   | (9)           |  | (9)             |
| Fair value adjustments of hedging instruments:   |                  |  |  |   |               |  |                 |
| • Unrealized gains (losses) from fair value adjustments of cash flow hedging derivatives |                  |  |  | (313)   | (313)         |  | (313)           |
| • Gains/losses transferred to the statement of income                                    |                  |  |  | 100   | 100           |  | 100             |
| Translation differences  |                  |  | (50)   |   | (50)          | (26)   | (76)            |
| Income taxes   |                  |  |  | 81  | 81            |  | 81              |
| <b>Income (loss) recognized directly in equity other comprehensive income (loss)</b>     |                  |  | <b>(50)</b>                                      | <b>(89)</b>   | <b>(139)</b>  | <b>(26)</b>  | <b>(165)</b>    |
| <b>Net income for the year</b>   |                  |  |  | <b>1,815</b>  | <b>1,815</b>  | <b>1,019</b>                                       | <b>2,834</b>    |
| <b>Total comprehensive income (loss) for the year</b>                                    |                  |  | <b>(50)</b>                                      | <b>1,726</b>  | <b>1,676</b>  | <b>993</b>   | <b>2,669</b>    |
| • Dividends approved   |                  |  |  | (1,730)   | (1,730)       | (1,050)  | (2,780)         |
| • Conversion of bonds  | 1                | 3  |  |   | 4             |  | 4               |
| • Exercise of stock options  | 10               | 30   |  |   | 40            | 207  | 247             |

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|   |              |           |             |              |               |              |               |
|---|--------------|-----------|-------------|--------------|---------------|--------------|---------------|
| • Dilution of TIM shares held following stock options                         |              |           |             | 66           | 66            | (66)         |               |
| • Effect of consolidation of TIM shares previously recorded in current assets |              |           |             |              |               | (20)         | (20)          |
| • Other changes   |              |           |             | (63)         | (63)          | (43)         | (106)         |
| <b>Balance at December 31, 2004 in accordance with IFRS</b>                   | <b>8,809</b> | <b>65</b> | <b>(50)</b> | <b>7,424</b> | <b>16,248</b> | <b>4,550</b> | <b>20,798</b> |

The accompanying notes are an integral part of these financial statements

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Financial Statements

Consolidated Statement Of Changes In Equity

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEARS ENDED DECEMBER 31, 2006, 2005 AND 2004**

## Equity attributable to equity holders of the Parent

|  | Share<br>capital | Reserve<br>for<br>additional<br>paid-in<br>capital | Reserve<br>for net<br>translation<br>differences | Other<br>reserves and<br>retained<br>earnings<br>(accumulated<br>losses),<br>including net<br>income (loss)<br>for the year | Total         | Equity<br>attributable<br>to Minority<br>Interests | Total<br>equity |
|--|------------------|--|--|---|---------------|--|-----------------|
| (millions of Euro)   |                  |  |  |   |               |  |                 |
| <b>Balance at December 31, 2004 in accordance with Italian GAAP</b>                      | <b>8,865</b>     | <b>120</b>   |  | <b>6,187</b>  | <b>15,172</b> | <b>4,689</b>                                       | <b>19,861</b>   |
| Adoption of IFRS   | (56)             | (55)   | (50)   | 1,237   | 1,076         | (139)  | 937             |
| <b>Balance at December 31, 2004 in accordance with IFRS</b>                              | <b>8,809</b>     | <b>65</b>  | <b>(50)</b>                                      | <b>7,424</b>  | <b>16,248</b> | <b>4,550</b>                                       | <b>20,798</b>   |
| <b>Changes in equity in 2005:</b>  |                  |  |  |   |               |  |                 |
| Fair value adjustments of available-for-sale financial assets:                           |                  |  |  |   |               |  |                 |
| • Unrealized gains (losses) from fair value adjustments                                  |                  |  |  | 57  | 57            |  | 57              |
| • Gains/losses transferred to the statement of income                                    |                  |  |  | (11)  | (11)          |  | (11)            |
| Fair value adjustments of hedging instruments:   |                  |  |  |   |               |  |                 |
| • Unrealized gains (losses) from fair value adjustments of cash flow hedging derivatives |                  |  |  | (122)   | (122)         |  | (122)           |
| • Gains/losses transferred to the statement of income                                    |                  |  |  | 75  | 75            |  | 75              |
| Translation differences  |                  |  | 848  |   | 848           | 357  | 1,205           |
| Income taxes   |                  |  |  | (1)   | (1)           |  | (1)             |
| <b>Income (loss) recognized directly in equity other comprehensive income (loss)</b>     |                  |  | <b>848</b>                                       | <b>(2)</b>  | <b>846</b>    | <b>357</b>   | <b>1,203</b>    |
| <b>Net income for the year</b>   |                  |  |  | <b>3,216</b>  | <b>3,216</b>  | <b>474</b>   | <b>3,690</b>    |
| <b>Total comprehensive income (loss) for the year</b>                                    |                  |  | <b>848</b>                                       | <b>3,214</b>  | <b>4,062</b>  | <b>831</b>   | <b>4,893</b>    |
| • Dividends approved   |                  |  |  | (1,912)   | (1,912)       | (430)  | (2,342)         |
| • Conversion of bonds  | 488              | 1,640  |  | (315)   | 1,813         |  | 1,813           |
| • Exercise of stock options  | 6                | 23   |  |   | 29            |  | 29              |
| • Cash tender offer and other purchases of shares  |                  |  |  |   |               | (2,124)  | (2,124)         |



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Financial Statements

Consolidated Statement Of Changes In Equity

## CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE YEARS ENDED

DECEMBER 31, 2006, 2005 AND 2004

| Equity attributable to equity holders of the Parent                                      |  |   |   |               |   |              |               |
|--|--|---|---|---------------|---|--------------|---------------|
| Share capital  | Reserve for additional paid-in capital | Reserve for net translation differences | Other reserves and retained earnings (accumulated losses), including net income (loss) for the year | Total         | Equity attributable to Minority Interests | Total equity |               |
| (millions of Euro)   |  |   |   |               |   |              |               |
| <b>Balance at December 31, 2005 in accordance with IFRS</b>                              | <b>10,599</b>                          | <b>6,465</b>                            | <b>793</b>  | <b>7,805</b>  | <b>25,662</b>                             | <b>1,323</b> | <b>26,985</b> |
| Application of Legislative Decree No. 38/2005  |  | (4,796)                                 |   | 4,796         |   |              |               |
| <b>Balance at December 31, 2005 in accordance with IFRS as adjusted</b>                  | <b>10,599</b>                          | <b>1,669</b>                            | <b>793</b>  | <b>12,601</b> | <b>25,662</b>                             | <b>1,323</b> | <b>26,985</b> |
| <b>Changes in equity in 2006:</b>  |  |   |   |               |   |              |               |
| Fair value adjustments of available-for-sale financial assets:                           |  |   |   |               |   |              |               |
| • Unrealized gains (losses) from fair value adjustments                                  |  |   |   | 68            | 68  |              | 68            |
| • Gains/losses transferred to the statement of income                                    |  |   |   |               |   |              |               |
| Fair value adjustments of hedging instruments:   |  |   |   |               |   |              |               |
| • Unrealized gains (losses) from fair value adjustments of cash flow hedging derivatives |  |   |   | (48)          | (48)                                      |              | (48)          |
| • Gains/losses transferred to the statement of income                                    |  |   |   | 290           | 290                                       |              | 290           |
| Translation differences  |  |   | (119)   |               | (119)                                     | (44)         | (163)         |
| Income taxes   |  |   |   | (83)          | (83)                                      |              | (83)          |
| <b>Income (loss) recognized directly in equity other comprehensive income (loss)</b>     |  |   | <b>(119)</b>  | <b>227</b>    | <b>108</b>                                | <b>(44)</b>  | <b>64</b>     |
| <b>Net income for the year</b>   |  |   |   | <b>3,014</b>  | <b>3,014</b>                              | <b>(11)</b>  | <b>3,003</b>  |
| <b>Total comprehensive income (loss) for the year</b>                                    |  |   | <b>(119)</b>  | <b>3,241</b>  | <b>3,122</b>                              | <b>(55)</b>  | <b>3,067</b>  |
| • Dividends approved   |  |   |   | (2,766)       | (2,766)                                   | (236)        | (3,002)       |
| • Conversion of bonds  | 6                                      | 20                                      |   | (4)           | 22  |              | 22            |

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|   |                   |                   |                   |                   |                   |                   |                   |
|---|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| • Exercise of stock options                                 |                   |                   |                   | 2                 | 2                 |                   |                   |
| • Reorganization of Mobile business segment in Brazil       |                   |                   | (59)              | (59)              | 59                |                   |                   |
| • Changes in the scope of consolidation                     | 12                |                   |                   | 12                | (15)              | (3)               |                   |
| • Other changes   |                   |                   | 25                | 25                | 2                 | 27                |                   |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |
| <b>Balance at December 31, 2006 in accordance with IFRS</b> | <b>10,605</b>     | <b>1,689</b>      | <b>686</b>        | <b>13,038</b>     | <b>26,018</b>     | <b>1,080</b>      | <b>27,098</b>     |
|   | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> | <u>          </u> |

The accompanying notes are an integral part of these financial statements

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Financial Statements

Consolidated Statements Of Cash Flows

**CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED****DECEMBER 31, 2006, 2005 AND 2004**

|  | Note  | Year ended December 31, |                 |                |
|--|-------|-------------------------|-----------------|----------------|
|  |       | 2006                    | 2005            | 2004           |
| (millions of Euro)   |       |                         |                 |                |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>   |       |                         |                 |                |
| Net income from continuing operations  |       | 2,996                   | 3,140           | 2,952          |
| <i>Adjustments to reconcile net income from continuing operations to cash flows generated by (used in) operating activities:</i> |       |                         |                 |                |
| Depreciation and amortization  |       | 5,487                   | 5,232           | 4,808          |
| Impairment (reversals) losses of non-current assets (including investments)  |       | 1                       | 3               | 446            |
| Net change in deferred tax assets and liabilities  |       | 1,843                   | 1,347           | 1,124          |
| Net (gains) losses realized on disposals of non-current assets (including investments)   |       | (317)                   | (327)           | (106)          |
| Share of (profits) losses of associates and joint ventures accounted for using the equity method                                 |       | (51)                    | (23)            | 5              |
| Change in employee severance indemnities and other employee-related provisions   |       | (114)                   | 255             | (39)           |
| Change in other operating assets/liabilities:  |       |                         |                 |                |
| • Change in inventories  |       |                         | (5)             | (24)           |
| • Change in trade receivables and net receivables on construction contracts  |       | (461)                   | 329             | 51             |
| • Change in trade payables   |       | (10)                    | 184             | 1,079          |
| • Net change in miscellaneous receivables/payables and other assets/liabilities  |       | (180)                   | (357)           | (30)           |
| <b>CASH FLOWS GENERATED BY (USED IN) OPERATING ACTIVITIES (A)</b>  |       | <b>9,194</b>            | <b>9,778</b>    | <b>10,266</b>  |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>   |       |                         |                 |                |
| Acquisitions of intangible assets on an accrual basis  | 6     | (2,187)                 | (1,785)         | (1,882)        |
| Acquisition of tangible assets on an accrual basis   | 7     | (2,927)                 | (3,388)         | (3,120)        |
| Total acquisitions of intangible and tangible assets on an accrual basis   |       | (5,114)                 | (5,173)         | (5,002)        |
| Change in amounts due to fixed asset suppliers (*)   |       | 10                      | 158             |                |
| Total acquisitions of intangible and tangible assets on a cash basis   |       | (5,104)                 | (5,015)         | (5,002)        |
| Acquisitions of investments in subsidiaries and businesses, net of cash acquired (I)   | 3,5,6 |                         | (390)           | (1)            |
| Acquisitions of other investments  | 3,5,8 | (206)                   | (14,544)        | (867)          |
| Change in financial receivables and other financial assets   |       | (264)                   | (474)           | 424            |
| Proceeds from sale of investments in subsidiaries, net of cash disposed of (II)  | 5,16  | 345                     | 2,052           | 43             |
| Proceeds from sale/repayments of intangible, tangible and other non-current assets (II)  |       | 1,038                   | 950             | 452            |
| <b>CASH FLOWS GENERATED BY (USED IN) INVESTING ACTIVITIES (B)</b>  |       | <b>(4,191)</b>          | <b>(17,421)</b> | <b>(4,951)</b> |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>   |       |                         |                 |                |
| Net change in current financial liabilities and other liabilities  |       | (204)                   | (1,053)         | 1,247          |

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|   |                |              |                |
|---|----------------|--------------|----------------|
| Proceeds from non-current financial liabilities (including current portion)               | 5,222          | 15,357       | 7,845          |
| Repayments of non-current financial liabilities (including current portion)               | (9,995)        | (3,151)      | (8,270)        |
| Proceeds from equity instruments  | 2              | 102          | 193            |
| Share capital increases/repayments  |                | (160)        | 51             |
| Dividends paid (distribution of reserves included)  | (2,997)        | (2,328)      | (2,780)        |
| <b>CASH FLOWS GENERATED BY (USED IN) FINANCING ACTIVITIES (C)</b>                         | <b>(7,972)</b> | <b>8,767</b> | <b>(1,714)</b> |
| <b>CASH FLOWS GENERATED BY (USED IN) DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE (D)</b> | 16             | (13)         | 26             |
| <b>AGGREGATE CASH FLOWS (E=A+B+C+D)</b>   | <b>(2,982)</b> | <b>1,150</b> | <b>3,492</b>   |
| <b>NET CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR (F)</b>                     | <b>9,958</b>   | <b>8,667</b> | <b>5,211</b>   |
| <b>Net effect of foreign currency translation on net cash and cash equivalents (G)</b>    | <b>(16)</b>    | <b>141</b>   | <b>(36)</b>    |
| <b>NET CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR (H=E+F+G)</b>                     | <b>6,960</b>   | <b>9,958</b> | <b>8,667</b>   |

(I) Net of change in payables arising from the related acquisition.

(II) Net of change in receivables arising from the related disposal.

(\*) Not available for the year ended December 31, 2004.

The accompanying notes are an integral part of these financial statements

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|   | Year ended December 31, |              |              |
|---|-------------------------|--------------|--------------|
|   | 2006                    | 2005         | 2004         |
|   | (millions of Euro)      |              |              |
| <b>ADDITIONAL CASH FLOW INFORMATION:</b>  |                         |              |              |
| Income taxes (paid)/received  | (566)                   | (708)        | (1,476)      |
| Interest expense paid   | (3,108)                 | (2,796)      | (2,779)      |
| Interest income received  | 1,156                   | 1,067        | 1,025        |
| Dividends received  | 63                      | 61           | 35           |
| <b>ANALYSIS OF NET CASH AND CASH EQUIVALENTS:</b>                                       |                         |              |              |
| <b>NET CASH AND CASH EQUIVALENTS AT THE BEGINNING OF THE YEAR:</b>                      |                         |              |              |
| • Cash and cash equivalents from continuing operations                                  | 10,323                  | 8,746        | 5,515        |
| • Bank overdrafts repayable on demand from continuing operations                        | (383)                   | (248)        | (510)        |
| • Cash and cash equivalents from discontinued operations/assets held for sale           | 37                      | 210          | 206          |
| • Bank overdrafts repayable on demand from discontinued operations/assets held for sale | (19)                    | (41)         |              |
|   | <b>9,958</b>            | <b>8,667</b> | <b>5,211</b> |
| <b>NET CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR:</b>                            |                         |              |              |
| • Cash and cash equivalents from continuing operations                                  | 7,219                   | 10,323       | 8,746        |
| • Bank overdrafts repayable on demand from continuing operations                        | (259)                   | (383)        | (248)        |
| • Cash and cash equivalents from discontinued operations/assets held for sale           |                         | 37           | 210          |
| • Bank overdrafts repayable on demand from discontinued operations/assets held for sale |                         | (19)         | (41)         |
|   | <b>6,960</b>            | <b>9,958</b> | <b>8,667</b> |

The accompanying notes are an integral part of these financial statements

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

**FORM AND CONTENT**

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

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

The head office of the Parent Company, Telecom Italia, is located in Milan, Italy.

The consolidated financial statements of the Telecom Italia Group are expressed in millions of euro which is also the currency of the primary economies in which the Group operates. Foreign subsidiaries are included in the consolidated financial statements in accordance with the accounting policies described in Note 2 Accounting policies .

The consolidated financial statements for the year ended December 31, 2006 have been prepared in accordance with IFRS issued by the International Accounting Standards Board and endorsed by the European Union ( **IFRS** ), and by the national laws in force. IFRS also include all effective International Accounting Standards ( **IAS** ) and all Interpretations issued by the International Financial Reporting Interpretations Committee ( **IFRIC** ), comprising those previously issued by the Standing Interpretations Committee ( **SIC** ).

The consolidated financial statements have been prepared under the historic cost convention, except for available-for-sale financial assets, financial assets held for trading and derivative instruments which have been measured at fair value, as well as discontinued operations/assets held for sale and the liabilities related to discontinued operations/assets held for sale which have been stated at the lower of carrying value or fair value less costs to sell. The carrying amounts of hedged assets and liabilities have been adjusted to reflect the changes in fair value of the hedged risks (fair value hedge).

The Group did not opt for the early adoption of any IFRS in 2006.

Minor changes have been made to the classification of certain items in the consolidated financial statements of prior years to allow comparison with the presentation in the consolidated financial statements at December 31, 2006.



**FINANCIAL STATEMENT FORMATS**

The financial statement formats adopted are consistent with those indicated in IAS 1. In particular:

- the consolidated balance sheets have been prepared by classifying the assets and liabilities according to current and non-current criterion and separately indicating on two lines Discontinued operations/assets held for sale and Liabilities relating to discontinued operations/assets held for sale as required by IFRS 5;
- the consolidated statements of income have been prepared by classifying the operating costs by nature of expense, since this form of presentation is considered more appropriate and representative of the specific business of the Group, and conforms to internal reporting and is in line with the industrial sector of reference. Moreover, results from continuing operations are shown separately from the Net income (loss) from discontinued operations/assets held for sale as required by IFRS 5;
- the consolidated statements of changes in equity have been prepared in conformity with the IAS 1;
- the consolidated statements of cash flows have been prepared by presenting financial flows from operating activities according to the indirect method, as permitted by IAS 7, and separately showing financial flows from Discontinued operations/assets held for sale, as required by IFRS 5.

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**SEGMENT INFORMATION**

The disclosure of segment information has been modified to present the Brazil Mobile segment separately from the Domestic Mobile segment in light of the increasing importance of the Brazilian mobile business and the organizational changes that took place during 2006.

The segment information presented for prior periods has been reclassified for purpose of comparison.

The accounting presentation by business segment is therefore as follows:

- Wireline
  
- Domestic Mobile
  
- Brazil Mobile
  
- Media
  
- Olivetti
  
- Other activities

**SEASONAL FACTORS AFFECTING REVENUES**

- **Wireline**

The trend of revenues from basic subscription charges and traffic relating to fixed telecommunications was not significantly affected by seasonal factors in 2006 with respect to 2005 and 2004. However, the promotional campaigns launched in 2006 had a positive effect on product sales.

- **Domestic Mobile**

The trend of voice traffic revenues relating to the domestic mobile business was not influenced by seasonal factors related to market campaigns. These campaigns, however, have an effect on the revenues from sales and marginally also on revenues from Valued Added Services (VAS). Nevertheless, there are seasonal phenomena relating to the number of holidays during the year.

- **Brazil Mobile**

The trend of revenues relating to the Brazil mobile business were only marginally affected by seasonal factors involving marketing campaigns but were influenced by seasonal phenomena relating to the number of holidays during the year.

#### SCOPE OF CONSOLIDATION

Excluding the effects of discontinued operations/assets held for sale at December 31, 2006 and 2005 (described below), the impact of the other changes in the scope of consolidation on the results of operations, the financial position and cash flows during 2006 and 2005 was not material.

The changes in the scope of consolidation at December 31, 2006 compared to December 31, 2005 can be summarized as follows:

a) inclusions in the scope of consolidation:

*Olivetti:* AdValso S.p.A (established in November 2006);

b) exclusions from the scope of consolidation:

*Wireline:* Telecom Media International Italy-Canada Inc. (wind-up closed in November 2006), Emax Trade S.r.l. (wind-up closed in November 2006) and Liberty Telecom B.V. (wind-up closed in December 2006);

*Olivetti:* Wirelab S.p.A. (partial sale of investment), Olivetti Tecnost Portugal S.A. (wind-up closed in May 2006) and Olivetti Tecnost H.K. Ltd (wind-up closed in October 2006);

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*Other activities:* Ruf Gestion S.a.S. (sold in March 2006), Olivetti International (Service) S.A. (wind-up closed in April 2006), Eustema S.p.A. (sold in April 2006), Consorzio Energia (wind-up closed in May 2006), Consorzio Formazione Area Mediterranea (reclassified to investments in associates), Telecom Italia Learning Services S.p.A. (sold in July 2006), Blah! Inc. (wind-up closed in October 2006) and Edotel S.p.A. (wind-up closed in December 2006);

c) merged companies:

effective January 2006, La7 Televisioni S.p.A. was merged with the parent Telecom Italia Media S.p.A.;

effective March 2006, Tim Italia S.p.A. was merged with the parent Telecom Italia S.p.A.;

effective March 2006, Blah!- Sociedade Anonima de Servicos e Comercio and CRC Centro de Relacionamento com Clientes were merged into the parent Tim Celular S.A., whose investment was later contributed by Tim Brasil S.A. to Tim Participações S.A.;

effective June 2006, Tim Sul S.A. was merged into Tim Celular S.A., Tim Nordeste Telecomunicações S.A. was merged into Maxitel S.A. and renamed Tim Nordeste S.A.;

effective October 2006, Nuova Tin.It S.r.l. was merged with the parent Telecom Italia S.p.A..

The changes in the scope of consolidation at December 31, 2005 compared to December 31, 2004 can be summarized as follows:

a) inclusions in the scope of consolidation:

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

*Other activities:* Progetto Italia S.p.A. (established in January 2005) and Ascai Servizi S.r.l. (controlling interest acquired in May 2005);

b) exclusions from the scope of consolidation:

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

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

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

c) merged companies:

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

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

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

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At December 31, 2006 and 2005, the subsidiaries, associates and joint ventures of Telecom Italia can be summarized as follows:

|  | At December 31, 2006 |               |            |
|--|----------------------|---------------|------------|
|  | Italy                | Outside Italy | Total      |
| <b>Companies:</b>                                    |                      |               |            |
| subsidiaries consolidated on a line-by-line basis    | 43                   | 85            | 128        |
| joint ventures accounted for using the equity method | 1                    | 1             | 2          |
| associates accounted for using the equity method     | 26                   | 7             | 33         |
| <b>Total companies</b>                               | <b>70</b>            | <b>93</b>     | <b>163</b> |

|   | At December 31, 2005 |               |            |
|---|----------------------|---------------|------------|
|   | Italy                | Outside Italy | Total      |
| <b>Companies:</b>                                     |                      |               |            |
| subsidiaries consolidated on a line-by-line basis (*) | 54                   | 100           | 154        |
| joint ventures accounted for using the equity method  | 1                    | 1             | 2          |
| associates accounted for using the equity method      | 31                   | 12            | 43         |
| <b>Total companies</b>                                | <b>86</b>            | <b>113</b>    | <b>199</b> |

(\*) Including subsidiaries held for sale.

For further details, see the Note 45 List of companies of the Telecom Italia Group .

**DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE**

As required by IFRS 5 (*Non-current assets held for sale and discontinued operations*), balance sheet and statement of income items relating to discontinued operations/ assets held for sale have been classified in two separate lines on the balance sheet in

Discontinued operations/assets held for sale and in Liabilities relating to discontinued operations/assets held for sale and in one line on the statement of income in Net income (loss) from discontinued operations/assets held for sale.

In particular:

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the 2006 statement of income includes the data of Digitel Venezuela (sold in May 2006);

the 2005 statement of income includes the data of: Digitel Venezuela (sold in May 2006), the Entel Chile group (sold in March 2005), Tim Hellas (sold at the beginning of June 2005), the Finsiel group (sold at the end of June 2005), Tim Perù (sold in August 2005) and Gruppo Buffetti (sold in January 2006);

the 2004 statement of income includes the data of: Entel Chile group (sold in March 2005), the Finsiel group and Tim Hellas (sold in June 2005), Tim Perù (sold in August 2005), the Gruppo Buffetti (sold in January 2006) and Digitel Venezuela (sold in May 2006);

the balance sheet at December 31, 2006 includes the investments held in Solpart Participações and Brasil Telecom Participações following the decision to proceed with their sale;

the balance sheet at December 31, 2005 includes the assets and liabilities of Digitel Venezuela and Gruppo Buffetti.

### **NOTE 2 ACCOUNTING POLICIES**

#### **CONSOLIDATION**

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

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

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In the preparation of the consolidated financial statements, assets, liabilities, revenues and expenses of the consolidated companies are consolidated on a line-by-line basis and minority interests in the equity and in the net income for the year are disclosed separately under appropriate captions, respectively, in the consolidated balance sheet and in the consolidated statement of income.

The carrying amount of the investment in each subsidiary is eliminated against the corresponding share of equity in each subsidiary, after adjustment, if any, to fair value at the acquisition date; any resulting difference is treated as goodwill and recognized in intangible assets, as described below.

All intragroup balances and transactions, and any unrealized gains and losses arising from intragroup transactions, are eliminated on consolidation.

Assets and liabilities of foreign consolidated subsidiaries expressed in currencies other than euro are translated using the exchange rates in effect at the balance sheet date (the current method). Income and expenses are translated at the average exchange rate for the year. Translation differences resulting from the application of this method are classified as equity until the disposal of the investment. The average exchange rates for the year are used to translate the cash flows of foreign consolidated subsidiaries included in the consolidated statement of cash flows.

For subsidiaries, associates and joint-ventures which adopt inflation accounting to eliminate distorting effects on the result for the year, the statement of income has been translated at the year-end exchange rates, as required by IAS 29 (*Financial reporting in hyperinflationary economies*), instead of at the average rates for the year.

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

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

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



Investments in associates and in joint-ventures are accounted for in the consolidated financial statements by the equity method, as provided, respectively, by IAS 28 (*Investments in associates*) and IAS 31 (*Interests in joint ventures*). Associates are enterprises in which the Group holds at least 20% of the voting rights or exercises a significant influence, but no control or joint control over the financial and operating policies.

The consolidated financial statements include the Group's share in the earnings of associates and joint-ventures accounted for by the equity method, from the date that significant influence commences until the date such influence ceases. When the Group's share of losses of an associate and joint-ventures, if any, exceeds the carrying amount of the investment on the Group's balance sheet, the carrying amount of the investment is reduced to zero and the share of further losses is not recognized except to the extent that the Group has an obligation to cover such losses.

Unrealized gains and losses arising from transactions with associates or joint-ventures are eliminated to the extent of the Group's interest in those entities.

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With regard to transactions for the acquisition and sale of interests in companies already controlled, in the absence of a Standard or a specific Interpretation on the matter and referring to IAS 8 (*Accounting policies, changes in accounting estimates and errors*), the Group has applied the following accounting treatments, identifying two types of transactions:

- *acquisition/sale of interests in companies already controlled:* in the case of acquisitions, the Group pays the minority interests in cash or by new shares and, at the same time, eliminates the relative share of the minority interest and records Goodwill equal to the excess of the acquisition cost over the carrying amount of the assets and liabilities acquired. In the case of sales, the difference between the proceeds of disposal of shares and the corresponding carrying amount on consolidation is recognized in the statement of income (Parent entity extension method);
- *intragroup transfers of interests in controlled companies which result in a change in the percentage of ownership:* the interests transferred remain recorded at historical cost and the gain or loss on the transfer is eliminated in full. The minority interests which do not directly take part in the transaction are adjusted to reflect the change in the respective share of equity with a corresponding opposite effect on the equity attributable to the equity holders of the Parent without recognition of any goodwill and however without generating any impact on net income or total equity.

**INTANGIBLE ASSETS***Goodwill*

In the case of the acquisition of a controlling interest in an enterprise, the identifiable assets, liabilities and contingent liabilities acquired (including minority interests) are recorded at fair value at the date of acquisition.

The excess of the cost of acquisition over the Group's interest in the fair value of those assets and liabilities acquired is recognized as goodwill and classified in the balance sheet as an intangible asset with an indefinite life. The excess of fair value over cost ( negative goodwill ) is recognized in the statement of income at the date of acquisition.

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

In accordance with IAS 36 (*Impairment of assets*), goodwill is tested for impairment annually, or more frequently, if specific events or changes in circumstances indicate that it may be impaired. However, impairment losses of goodwill are not reversed when the underlying assumptions no longer exist. For additional details, please refer to the following *Impairment of assets Goodwill*.

When a business, or part thereof, is sold, the relative fair value of goodwill is taken into account in calculating the gain or loss on disposal.

In the context of IFRS first-time adoption, the Group elected not to apply IFRS 3 (*Business Combinations*) retrospectively to those business combinations which had arisen before January 1, 2004. As a consequence, goodwill on acquisitions before the date of transition to IFRS has been retained (except for possible effects arising from the application of the new standards) at the previous Italian GAAP amounts, and was tested for impairment at that date.

*Development costs*

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

Capitalized development costs comprise only expenditures that can be attributed directly to the development process and are amortized systematically from the start of production over the estimated product or service life.

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*Other intangible assets with a finite life*

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

Such assets are recorded at purchase or development cost, or, for those assets existing at the transition date to IFRS (January 1, 2004), at the deemed cost which for certain assets is the revalued cost, and amortized on a straight-line basis over their estimated useful lives. Intangible assets with finite useful lives are also tested for impairment annually or more frequently, whenever there is an indication that the asset may be impaired.

Amortization is calculated on a straight-line basis over the estimated useful life of the assets. The amortization rates are reviewed yearly and revised if the current estimated useful life is different from that estimated previously. The effect of such changes is recognized in the statement of income prospectively.

**TANGIBLE ASSETS PROPERTY, PLANT AND EQUIPMENT OWNED**

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

Cost also includes the expected costs of decommissioning the asset and restoring the site if a legal or constructive obligation exists. The corresponding liability is recognized in the period in which the obligation arises in a balance sheet provision under the provisions for risks and charges. These capitalized costs are depreciated and charged to the statement of income over the useful life of the related tangible assets.

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

Land, including the land appurtenant to the buildings, is not depreciated.

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These depreciation rates are reviewed yearly and revised if the current estimated useful live is different from that estimated previously. The effect of such changes is recognized in the statement of income prospectively.

In 2006, a complete review of the useful lives of tangible assets was undertaken because of the following recent developments:

- integration of fixed and mobile telecommunications;
- planning of a New Generation Network (NGN) to support the domestic broadband services market.

Such changes led to an extension of the relative useful lives for some assets (power supply and air-conditioning systems and transmission installations).

As part of the review of the depreciation rates, technical evaluations of the tangible assets were made and account was taken of technological innovation, market evolution and market comparisons.

The revision of the depreciation rates led to a reduction in the depreciation charge for the year 2006 of 319 million and, assuming that other existing conditions remain the same, will lead to a reduction in the depreciation charge of 193 million in 2007 and 159 million in 2008.

The minimum and maximum depreciation rates used in 2006, 2005 and 2004 are the following:

|  | <b>Depreciation rates</b> |
|--|---------------------------|
| Civil and industrial buildings           | 3%-7%                     |
| Plant and equipment                      | 3%-33%                    |
| Manufacturing and distribution equipment | 15%-25%                   |
| Ships                                    | 9%                        |
| Other                                    | 11%-33%                   |

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**TANGIBLE ASSETS ASSETS HELD UNDER FINANCE LEASES**

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

Furthermore, gains realized on sale and leaseback transactions that are recorded under the finance method are deferred over the shorter of the lease term and the remaining useful life of the asset.

Since there is no reasonable certainty over the acquisition of the ownership of the asset at the end of lease period, assets held under finance leases are depreciated over the shorter of the lease term and their useful lives.

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

**IMPAIRMENT OF ASSETS**

*Goodwill*

Goodwill is tested for impairment at least once a year to assess the recoverable amount of the asset.

The test is conducted in conjunction with the planning process of the Group, near the end of every year. Therefore, the date of testing is the year-end closing date of the financial statements. Goodwill acquired and allocated during the year is tested for impairment by the end of the year in which the acquisition and allocation took place.

To test for impairment, goodwill is allocated, at the date of acquisition, to each cash-generating unit or group of cash-generating units which is expected to benefit from the acquisition. Allocation is made to the lowest level at which goodwill is monitored for management purposes. This minimum level must never be at a higher level than the business segment determined in accordance with IAS 14 (*Segment Reporting*).

If the carrying amount of the cash-generating unit (or group of cash-generating units) exceeds the recoverable amount, an impairment loss is recognized in the statement of income. The impairment loss is first recognized as a deduction of the carrying

amount of goodwill allocated to the cash-generating unit (or group of cash-generating units) and then only applied to the other assets of the cash-generating unit in proportion to their carrying amount, up to the recoverable amount of the assets with a finite life. The recoverable amount of a cash-generating unit, or group of cash-generating units, to which goodwill is allocated, is the higher of fair value less costs to sell and its value in use.

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

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

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

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

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

When the conditions that gave rise to an impairment loss no longer exist, the original amount of goodwill is not reinstated, as set forth in IAS 36 (*Impairment of assets*).

*Intangible and tangible assets with a finite life*

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

If indicators of an impairment exist, the carrying amount of the assets is reduced to the recoverable amount. The recoverable amount of an asset is the higher of fair value less costs to sell and its value in use. In calculating the value in use, the estimated future cash flows are discounted to present value using a discount rate that reflects current market views of the time value of money and the risks specific to the asset. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

An impairment losses are recognized in the statement of income.

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

**FINANCIAL INSTRUMENTS**



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

*Investments in other companies*

Investments in other companies (other than those in subsidiaries, associates and joint-ventures) are classified upon acquisition as available-for-sale financial assets in current or non-current assets or as financial assets at fair value through profit or loss in current assets.

Such investments are valued at fair value or at cost in the case of unlisted companies or investments whose fair value cannot be determined reliably, adjusted by any impairment losses, as required by IAS 39 (*Financial instruments: recognition and measurement*). Changes in the value of investments classified as available-for-sale,

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if valued at cost, are recognized directly in the statement of income; those valued at fair value are recognized in a specific equity reserve until the financial asset is disposed of or impaired at which time the equity reserve is reversed to the statement of income. Changes in the value of investments classified as assets at fair value through profit or loss are recognized directly in the statement of income.

*Securities other than investments*

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

The amortized cost is represented by the initial amount of the financial instrument net of repayments of principal already received, adjusted (up or down) on the basis of the amortization (using the effective interest method) of any differences between the initial amount and the amount at maturity, less any writedown for impairment or uncollectibility.

Securities other than investments classified as current assets are those that, by decision of the directors, are intended to be kept in the Group's portfolio for a period of not more than 12 months, and are included in the following categories:

- held to maturity (originally more than 3 months but less than 12 months, or, with an original maturity of more than 12 months but the remaining maturity at the date of purchase is more than 3 months but less than 12 months) and measured at amortized cost;
- held for trading and measured at fair value through profit or loss;
- available-for-sale and measured at fair value with a contra-entry to an equity reserve.

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

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

*Receivables and loans*

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

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

*Cash and cash equivalents*

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

Cash includes cash on hand and valuables.

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

*Impairment of financial assets*

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

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*Financial liabilities*

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

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

Compound financial instruments represented by bonds convertible into shares of the issuer are recognized by separating the debt and the call option: the debt is included in financial liabilities using the amortized cost method while the call option amount, computed as the difference between the fair value of the debt and the nominal amount of the financial instrument, is classified in a specific equity reserve (Other equity instruments).

Compound financial instruments represented by bonds exchangeable with shares of entities other than the issuer are recognized by splitting the debt and the call option: the debt is included in financial liabilities using the amortized cost method while the call option amount is classified as a written option among the financial liabilities and measured at fair value. Changes in fair value are recognized in the statement of income at each reporting date.

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

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

*Derivative financial instruments*

Derivative financial instruments are used by the Telecom Italia Group to manage its exposure to exchange rate and interest rate risks and to diversify the parameters of debt so that costs and volatility can be reduced to within prefixed operational limits.

In accordance with IAS 39, derivative financial instruments qualify for hedge accounting only when:

- a) at the inception of the hedge there is formal designation and documentation of the hedging relationship;
- b) the hedge is expected to be highly effective;
- c) its effectiveness can be reliably measured;
- d) it is highly effective throughout the financial reporting periods for which the hedge is designated.

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

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

- *Fair value hedge* Where a derivative financial instrument is designated as a hedge of the exposure to changes in fair value of an asset or liability due to a particular risk, the gain or loss from re-measuring the hedging instrument at fair value is recognized in the statement of income. The gain or loss on the hedged item attributable to the hedged risk adjusts the carrying amount of the hedged item and is recognized in the statement of income.
- *Cash flow hedge* Where a derivative financial instrument is designated as a hedge of the exposure to variability in cash flows of an asset or liability or a highly probable forecasted transaction, the effective portion of any gain or loss on the derivative financial instrument is recognized directly in a specific equity reserve (*Reserve for fair value adjustments of hedge instruments*). The cumulative gain or loss is

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removed from equity and recognized in the statement of income at the same time as the hedged transaction affects the statement of income. The gain or loss associated with the ineffective portion of a hedge is recognized in the statement of income immediately. If the hedged transaction is no longer probable, the cumulative unrealized gains or losses included in the equity reserve are immediately recognized in the statement of income.

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

**SALES OF RECEIVABLES**

During the first half of 2006, the Telecom Italia Group sold a significant part of its receivables through the securitization program which ended on July 25, 2006.

In December 2005, the securitization program was partly restructured by a Master DPP Transfer Agreement (or Framework Agreement for the sale of the Deferred Purchase Price (DPP)) signed between Telecom Italia S.p.A. and certain financial institutions under which the DPP on Telecom Italia S.p.A. receivables relating to invoices issued between October 1, 2005 and May 31, 2006 were sold without recourse to such financial institutions.

Consequently, as a result of the sale of the DPP without recourse, the risks and rewards of ownership of such receivables were transferred in full to the financial institutions which, having taken over control of the Special Purpose Entity (SPE) according to the criteria established in SIC 12, consolidate TI Securitisation Vehicle S.r.l. (TISV).

Commencing June 2006, Telecom Italia put into place contracts for the sale of the similar receivables under the factoring Law 52/91 on factoring. These sales are characterized by the transfer of all the risks and rewards of ownership of the receivables to third parties and thus meet IFRS requirements for derecognition. Specific servicing contracts, through which the buyer institutions conferred a mandate to Telecom Italia S.p.A. for the collection and management of the receivables, leave the current Company/customer relationship unaffected.

Other receivables are sold by Telecom Italia under factoring agreements which, in the majority of cases, meet IFRS requirements for asset derecognition.

In some cases, however, certain receivables sold to factoring companies do not meet IFRS requirements for derecognition. These are sales of mainly receivables due from the tax authorities for income taxes, primarily carried out in prior year. Such receivables were legally sold without recourse but Telecom Italia has provided a first loss guarantee up to a limited amount or retained a continuing significant risk related to the connected cash flows. In these cases, since the risks were not substantially transferred to the third parties, the receivables sold remain in the financial statements and a corresponding financial liability is recorded for the same amount.

**RECEIVABLES FOR CONSTRUCTION CONTRACTS**

Construction contracts, regardless of the duration of the contracts, are recognized in accordance with the stage of completion and classified as receivables in current assets. Losses on such contracts, if any, are recorded in full in the statement of income when they become known.

**INVENTORIES**

Inventories of raw materials, purchased products, semifinished goods, work in progress and finished goods are valued at the lower of cost or estimated realizable value, cost being determined on a weighted average cost (by single movement) basis. The valuation of inventories includes the direct costs of materials, labor and indirect production costs (variable and fixed). Provision is made for obsolete and slow-moving raw materials, finished goods, spare parts and other supplies based on their expected future use and estimated realizable value.

**DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE**

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

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In accordance with IFRS, discontinued operations/assets held for sale are presented in the financial statements as follows:

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

**EMPLOYEE BENEFITS**

*Provision for employee severance indemnities*

The Provision for employee severance indemnities, mandatory for Italian companies pursuant to art. 2120 of the Italian Civil Code, is considered a defined benefit plan under IFRS and is based, among other things, on the employees' years of service and the remuneration earned by the employee during the service period.

In accordance with IAS 19, the amount of provision to be recognized in the financial statements is determined by actuarial calculations using the Projected Unit Credit Method. As allowed by IFRS 1 and IAS 19, the Telecom Italia Group has elected, in the context of IFRS first-time adoption and for subsequent years, to recognize all actuarial gains and losses in the statement of income as they arise.

The expenses relative to the increase in the present value of the severance indemnity obligation, as the time for payment of the benefit comes closer, are included in Personnel costs in the statement of income.

*Stock compensation plans*

Stock option plans granted starting from January 1, 2005 are recognized in accordance with IFRS 2 (*Share-based Payment*).

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

For the valuation of stock option plans, the Telecom Italia Group uses the binomial Cox-Ross-Rubenstein (CRR) model. This model calculates the possible values which the underlying stock can assume over the life of the option.



The companies of the Group provide additional benefits to certain managers and employees through stock compensation plans (stock options). In accordance with IFRS 2 (*Share-based Payment*), employee stock options are measured at fair value at the grant date using models that take account of circumstances applicable at the grant date (option exercise price, vesting period, current price of the underlying shares, expected share price volatility, expected dividends and interest rate for a risk-free investment over the option term).

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

At the end of each year, the previously determined fair value of each option is not restated or updated, but maintained in equity. However, at that date, the Group reviews the estimated number of options that will vest until expiry based on the number of employees who will have exercise rights. The change in estimate must be deducted from or added to *Other equity instruments* with a contra-entry recorded in the statement of income in *Personnel costs* .

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

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**PROVISIONS FOR RISKS AND CHARGES**

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

Changes in estimates are reflected in the statement of income in the year in which the changes occur.

**TREASURY SHARES**

Treasury shares are recognized as a deduction from equity. In particular, the nominal amount of treasury shares is reported as a deduction from the share capital issued while the excess portion of cost at acquisition over the nominal amount is presented as a reduction of Other reserves .

**FOREIGN CURRENCY TRANSACTIONS**

Transactions in foreign currencies are recorded at the foreign exchange rate prevailing at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated at the foreign exchange rate prevailing at the balance sheet date. Exchange differences arising from the settlement of monetary items or from their conversion at rates different from those at which they were initially recorded during the year or in previous financial statements, are recognized in the statement of income.

**REVENUE RECOGNITION**

Revenues are recognized to the extent that it is probable that the economic benefits will flow to the Group and the revenues can be reliably measured. Revenues are stated net of discounts, allowances, and returns. Traffic revenues from interconnection and roaming are reported gross of the amounts due to other TLC operators.

Revenues from services rendered are recognized in the statement of income according to the prorata performance of the transaction and only when the outcome of the service rendered can be estimated reliably. Revenues from the activation of telephone services (and related costs) are deferred over the expected duration of the relationship with the customer (mainly 8 years for retail customers and 3 years for wholesale customers).

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Revenues from prepaid traffic are recorded on the basis of the minutes used at the contract price per minute. Deferred income for unused minutes is recorded in Trade and miscellaneous payables and other current liabilities. When customers recharge their prepaid cards they pay a fixed amount as Recharging income. The revenues from Recharging income and the relative costs (amounts paid to resellers, banks and other parties), with the latter not exceeding the Recharging income, are deferred over the period between two subsequent recharges (about one month).

The Group capitalizes, as intangible assets, directly attributable subscriber acquisition costs (represented by commissions for the sales network and subsidies for the purchase of handsets) when the following conditions are met:

- the costs can be clearly identified;
- there is a contract binding the customer for a specific period of time;
- it is probable that the amount of the costs will be recovered through the sales generated by the service contract, or, where the customer withdraws from the contract in advance, through the collection of the penalty.

Capitalized costs are amortized over the period of underlying contract.

In all other cases, subscriber acquisition costs are expensed when incurred.

Revenues from construction contracts are recognized based on the percentage of completion method.

### **ADVERTISING EXPENSES**

Advertising expenses are charged to the statement of income as incurred.

### **RESEARCH COSTS**

Research costs are charged directly to the statement of income in the year in which they are incurred.

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Income taxes include all taxes calculated on the basis of the taxable income of the companies of the Group, including relative incidental expenses of a non-financial nature (e.g. penalties). The relative interest expenses are recognized in Financial expenses .

Income taxes are recognized in the statement of income except to the extent that they relate to items directly charged or credited to equity, in which case the related income tax effect is recognized in equity. Accruals for income taxes that could arise on the remittance of a subsidiary's retained earnings are only made where there is the actual intention to remit such earnings. Other taxes, other than income taxes, are included in either operating expenses or financial expenses, depending on the case.

Deferred tax assets/liabilities are provided using the Balance sheet liability method . They are calculated on all temporary differences that arise between the tax base of an asset or liability and the carrying amounts in the consolidated financial statements except for non tax-deductible goodwill and for those differences related to investments in subsidiaries which will not reverse in the foreseeable future. Deferred tax assets relating to unused tax loss carryforwards and tax credits are recognized to the extent that it is probable that future profits will be available against which they can be utilized. Current and deferred tax assets and liabilities are offset when the income taxes are levied by the same tax authority and where there is a legally enforceable right of offset. Deferred tax assets and liabilities are determined based on enacted tax rates in the respective jurisdictions in which the Group operates that are expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

**DIVIDENDS**

Dividends received from companies other than subsidiaries, associates and joint-ventures are recognized in the statement of income in the period in which they become receivable following the resolution by the shareholders' meeting for the distribution of dividends of the investee companies.

Dividends payable to third parties are reported as a change in equity in the year in which they are approved by the shareholders' meeting.

**EARNINGS PER SHARE**

Basic earnings per ordinary share is calculated by dividing the Group's net income attributable to Ordinary Shares by the weighted average number of Ordinary Shares outstanding during the year, excluding treasury shares. Similarly, basic earnings per savings share is calculated by dividing the Group's net income attributable to savings shares by the weighted average number of savings shares outstanding during the year. For diluted earnings per ordinary share, the weighted average number of shares outstanding is adjusted by all dilutive potential shares from the conversion of bonds and the exercise of warrants. The Group net income is also adjusted to reflect the impact of these transactions net of the related tax effects.

**USE OF ESTIMATES AND JUDGMENTS**

The preparation of consolidated financial statements and related disclosures that conform to IFRS requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates. Estimates and judgments are used to arrive at the recoverable amount of non-current assets (including goodwill), revenues, bad debt accruals, obsolete and slow-moving inventories, depreciation and amortization, employee benefits, taxes, restructuring provisions and other accruals and provisions. Estimates and assumptions are reviewed periodically and the effects of any changes are reflected immediately in the statement of income.

In the absence of a Standard or an Interpretation that specifically applies to a transaction, management uses its judgment as to which accounting methods to adopt to disclose relevant and reliable information so that the financial statements:

represent faithfully the financial position, the result of operations and cash flows of the Group;

reflect the economic substance of transactions;

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are neutral;

are prudent;

are complete in all material respects.

**NEW STANDARDS AND INTERPRETATIONS ENDORSED BY THE EUROPEAN UNION EFFECTIVE BEGINNING ON JANUARY 1, 2006**

*Amendments to IAS 19 Employee benefits*

Such amendments, endorsed by the European Union in November 2005 (Regulation EC 1910-2005), provide, among other things, the option of recognizing actuarial gains and losses in full in the period in which they occur, not in the statement of income but directly in a specific reserve in equity.

The Telecom Italia Group did not elect this option and recognizes all actuarial gains and losses immediately in the statement of income in the year in which they occur.

*IFRIC 4 Determining whether an arrangement contains a lease*

Such Interpretation, endorsed by the European Union in November 2005 (Regulation EC 1910-2005), states that if an arrangement does not have the legal form of a lease but contains a lease, such lease should be classified as a finance or operating lease in accordance with IAS 17 (*Leasing*).

The application of this Interpretation did not have any effect on the consolidated financial statements at December 31, 2006.

*Amendments to IAS 39 Application of the fair value option*

Such amendments, endorsed by the European Union in November 2005 (Regulation EC 1864-2005), restrict the use of the fair value option to designate every financial asset or liability as measured at fair value through profit or loss. Such change in the Standard restricts the use of this option to those financial instruments which meet the following conditions:

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- the designation according to the fair value option significantly eliminates or reduces an accounting mismatch;
- a group of financial assets, financial liabilities or both are managed, and their performance is valued, on a fair value basis in accordance with a documented risk or investment management strategy;
- an instrument contains an implicit derivative which meets specific conditions.

The Group elected to use the fair value option only for assets and liabilities which are effectively held for trading starting from January 1, 2006. The adoption of these amendments had no effect on the consolidated financial statements at December 31, 2006.

### *Amendments to IAS 39 Cash flow hedge accounting of forecast intragroup transactions*

Such amendment, endorsed by the European Union in December 2005 (Regulation EC 2106-2005), allows a planned highly probable intragroup forecast transaction expressed in foreign currency to be designated as a hedged item in a cash flow hedge in consolidated financial statements, provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect the consolidated statement of income.

This amendment did not have any impact on the consolidated financial statements at December 31, 2006.

### *Amendments to IAS 39 and IFRS 4 Financial guarantee contracts*

Such amendments, endorsed by the European Union in January 2006 (Regulation EC 108-2006), extend the scope of IAS 39 to include the recognition of financial guarantee contracts by the issuer (guarantor). However, if an issuer has previously stated explicitly that such contracts are considered as insurance contracts and has accounted for them as such, it may elect to apply either IAS 39 or IFRS 4 to such financial guarantee contracts.

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The Telecom Italia Group has elected to measure the guarantees in accordance with IAS 39 and consequently the introduction of this amendment did not produce an impact on the consolidated financial statements at December 31, 2006.

*IFRIC 6 Liabilities arising from participating in a specific market Waste electrical and electronic equipment*

Such Interpretation, endorsed by the European Union in January 2006 (Regulation EC 108/2006), was published after the adoption of the European Union Directive on Waste Electrical and Electronic Equipment (WE&EE) which requires member states to implement a regulated system for the collection, treatment, recovery and ecologically correct decommissioning of the waste of electrical and electronic equipment. This Interpretation provides guidelines on the recognition of liabilities for such waste management in the financial statements of producers of electrical equipment based on the sales of such equipment to private households before August 13, 2005 (so-called historical waste). IFRIC 6 has clarified that what triggers the recognition of an accrual for the management costs of such waste, in accordance with IAS 37 (*Provisions, contingent liabilities and contingent assets*), is participation in the market during the measurement period. Consequently, since the obligation arises only on condition that a share of the market exists during the measurement period, the time frame for recognition can be independent of the specific period in which the activities for the management of the waste were undertaken and the relative costs were incurred.

The Italian government has not as yet enacted the necessary decrees for implementation: therefore, in the absence of a reference framework, the Group is not currently able to evaluate the impact, if any, of the application of this Interpretation on the financial statements.

**NEW STANDARDS AND INTERPRETATIONS ENDORSED BY THE EUROPEAN UNION BUT NOT YET EFFECTIVE**

As required by IAS 8 (*Accounting policies, changes in accounting estimates and errors*) the IFRS in effect from January 1, 2007 or subsequently are indicated below and briefly illustrated.

*IFRS 7 Financial instruments: disclosures*

This Standard, endorsed by the European Union in January 2006 (Regulation EC 108/2006), completely replaces IAS 30 (*Disclosures in financial statements of banks and other financial institutions*) and includes the section on Disclosures contained in IAS 32 (*Financial instruments: presentation and disclosures*) with amendments and revisions; consequently, the title of IAS 32 is changed to *Financial instruments: presentation* .

IFRS 7 is effective starting on January 1, 2007.



*Amendments to IAS 1 Presentation of Financial Statements Capital Disclosures*

Such amendments, endorsed by the European Union in January 2006 (Regulation EC 108-2006), provide that an entity must present disclosures which allow the users of its financial statements to assess its objectives, its policies and its processes for managing capital.

These amendments are effective starting on January 1, 2007.

*IFRIC 8 Scope of IFRS 2*

On September 8, 2006, the European Commission endorsed Interpretation IFRIC 8 (*Scope of IFRS 2*) with Regulation EC 1329-2006.

IFRIC 8 clarifies that IFRS 2 (Share-based Payment) applies to contracts where an entity makes share-based payments also for services for apparently nil or inadequate consideration.

IFRIC 8 specifically explains that if the identifiable consideration given appears to be less than the fair value of the equity instruments granted (or liability incurred), this situation typically indicates that other consideration has been or will be received.

This Interpretation is effective starting on January 1, 2007.

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It is not believed that this Interpretation will have any relevant impact on the consolidated financial statements of the Group.

*IFRIC 9 Reassessment of embedded derivatives*

On September 8, 2006, the European Commission endorsed Interpretation IFRIC 9 (*Reassessment of embedded derivatives*) with Regulation EC 1329-2006.

This Interpretation concludes that an entity must assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is prohibited unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment on the separation of the embedded derivative is required.

This Interpretation is effective starting on January 1, 2007.

It is not believed that this Interpretation will have any relevant impact on the consolidated financial statements of the Group.

**NOTE 3 BUSINESS COMBINATIONS, ACQUISITIONS OF MINORITY INTERESTS AND TRANSACTIONS BETWEEN COMPANIES UNDER COMMON CONTROL**

**BUSINESS COMBINATIONS**

**YEAR 2006**

In 2006, there were no transactions involving business combinations as defined in IFRS 3.

**YEAR 2005**

***Acquisition of Liberty Surf Group S.A.***

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In 2005, the entire investment in the capital of the company Liberty Surf Group S.A. was purchased from Tiscali for a total cost of 268 million (inclusive of 6 million for incidental charges).

The difference of 257 million between the price paid ( 268 million) and the net assets acquired ( 11 million), less pre-existing goodwill ( 34 million), was allocated as follows:

|                    |   |
|--------------------|---|
| 249 million        | to Goodwill   |
| 13 million         | to Intangible assets with a finite life Customer List |
| -5 million         | to Deferred tax liabilities                           |
| <hr/>              |   |
| <b>257 million</b> |   |
| <hr/>              |   |

The value of the Customer List has been determined on the basis of the Subscriber Acquisition Costs (SAC) for the customers acquired. The replacement cost method was elected in lieu of the income method owing to the fact that Tiscali's customer wholesale business showed a loss at the date of purchase.

The goodwill arising on acquisition ( 249 million) was tested for impairment at the date of purchase. The value in use of the company acquired served as the basis of reference and consideration was also given to the synergies expected from the merger with Telecom Italia France. There was no indication of impairment.

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|  | <u>Fair values</u>   | <u>Carrying values</u> |
|--|----------------------|------------------------|
|  | (millions of Euro)   |                        |
| Goodwill   | 249                  | 34                     |
| Other non-current assets   | 76                   | 63                     |
| Total current assets   | <u>68</u>            | <u>68</u>              |
| <b>Total assets</b>  | <b><u>393</u></b>    | <b><u>165</u></b>      |
| Deferred tax liabilities   | 5                    |                        |
| Other non-current liabilities                                    | 21                   | 21                     |
| Total current liabilities  | <u>99</u>            | <u>99</u>              |
| <b>Total liabilities</b>   | <b><u>125</u></b>    | <b><u>120</u></b>      |
| <b>Net assets acquired</b>                                       | <b><u>(*)268</u></b> | <b><u>45</u></b>       |
| <i>(*) Of which:</i>   |                      |                        |
| <i>Cost of the investment</i>                                    | 262                  |                        |
| <i>Incidental charges (taxes, legal fees and other expenses)</i> | <u>6</u>             |                        |
| <b>Total acquisition cost</b>                                    | <b><u>268</u></b>    |                        |

The effect of the acquisition of Liberty Surf Group on the 2005 statement of income was not significant while the impact on the net financial position was an increase in debt of 259 million (268 million for the price paid net of 9 million of cash and cash equivalents acquired).

**Acquisition of Elefante TV and Delta TV**

On October 28, 2005 and November 4, 2005, after necessary regulatory approvals, the agreements were finalized for the purchase of the Elefante TV and Delta TV business segments, respectively, for 116 million and 12 million.

The transaction was completed by the contribution of Elefante TV's and Delta TV's business segments to Telecom Italia Media Broadcasting in exchange for shares and, simultaneously, the sale to LA7 Televisioni, by the previous owners, of the shares issued by Telecom Italia Media Broadcasting following the contribution.

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The business segments contributed include the whole of the assets and operations functionally required for conducting the TV broadcasting business, such as the stations and the frequencies, the Elefante TV brand, the plant, equipment and sundry instruments, antennas, radio links, relay stations and other assets connected with radio and television operations using analog or digital technology. Also contributed were the contracts dealing with the housing and maintenance of the systems for radio and TV broadcasting and all the rights, permits, licenses, concessions (including the concession issued by the Ministry of Communications on July 28, 1999), relative to this business.

The difference of 126 million between the price paid ( 128 million) and the net assets acquired ( 2 million) was allocated as follows:

|                    |   |
|--------------------|---|
| 41 million         | to Goodwill   |
| 126 million        | to Intangible assets with a finite life Station frequencies and TV Station rights |
| - 41 million       | to Deferred tax liabilities   |
| <hr/>              |   |
| <b>126 million</b> |   |
| <hr/>              |   |

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|  | <u>Fair values</u> | <u>Carrying values</u> |
|--|--------------------|------------------------|
|  | (millions of Euro) |                        |
| Goodwill   | 41                 |                        |
| Station frequencies  | 114                |                        |
| Television station rights  | 12                 |                        |
| Other assets   | 3                  | 3                      |
| <b>Total assets</b>  | <b>170</b>         | <b>3</b>               |
| Payables and other liabilities                                   | 1                  | 1                      |
| Deferred tax liabilities   | 41                 |                        |
| <b>Total liabilities</b>   | <b>42</b>          | <b>1</b>               |
| <b>Net assets acquired</b>                                       | <b>(*)128</b>      | <b>2</b>               |
| <i>(*) Of which:</i>   |                    |                        |
| <i>Cost of businesses acquired</i>                               | 127                |                        |
| <i>Incidental charges (taxes, legal fees and other expenses)</i> | 1                  |                        |
| <b>Total acquisition cost</b>                                    | <b>128</b>         |                        |

**YEAR 2004**

In 2004, there were no transactions entered into of the type of business combinations defined in IFRS 3.

**ACQUISITIONS/DIVESTITURES OF MINORITY INTERESTS****YEAR 2006**

In 2006, there were no acquisitions and divestitures of minority interests.

**YEAR 2005**

**Telecom Italia/TIM merger**

The merger of Telecom Italia/TIM was finalized on June 30, 2005 with the merger of TIM in Telecom Italia.

In summary, the merger was executed in the following stages:

- Cash tender offer for TIM ordinary and savings shares (launched and closed by Telecom Italia in January 2005) and additional purchases of TIM shares (during the early months of 2005). Details are as follows:

|  |                           |
|--|---------------------------|
| 2,456,501,605 ordinary shares acquired in the cash tender offer for  | 13,854 million            |
| 8,463,127 savings shares acquired in the cash tender offer for       | 48 million                |
| 5,063,893 additional purchases of ordinary and savings shares for    | 28 million                |
| <b>Total 2,470,028,625 ordinary and savings shares purchased for</b> | <b>(1) 13,930 million</b> |

(1) Including capitalized costs of 98 million relating to the cash tender offer.

- Telecom Italia capital increase to service the merger by the issue of:

|   |                      |
|---|----------------------|
| 2,150,947,060 Ordinary Shares ( 2.595 per share) for  | 5,582 million        |
| <b>less:</b> 24,607,520 shares issued by Telecom Italia to be issued in exchange for 14,224,000   |                      |
| TIM shares held by Telecom Italia Finance ( 2.595 per share) for  | (64) million         |
| 230,199,592 Savings Shares ( 2.156 per share) for   | 496 million          |
| <b>Total 2,356,539,132 Ordinary and Savings Shares issued, net of 24,607,520 shares in exchange for 14,224,000 TIM shares held by Telecom Italia Finance, for</b> | <b>6,014 million</b> |

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The part of the merger for the percentage of ownership held previous to the cash tender offer was accounted for at the carrying amount in the financial statements at December 31, 2005 since the merged company was already controlled by the merging company and thus the conditions for the application of IFRS 3 (*Business combinations*) did not exist.

The acquisition of the remaining TIM shares through the cash tender offer and additional share purchases on the market, and the subsequent merger, were treated as a purchase of minority interests, which is not dealt with either by IFRS 3 or any other IFRS.

This transaction was accounted for in the consolidated financial statements at December 31, 2005 at fair value by applying the parent-entity extension method. This method resulted in the recognition of goodwill (difference between the fair value of the shares purchased and the newly issued shares and the share of the carrying value of TIM's net assets acquired) of 16,654 million, of which 11,804 million came from the cash tender offer and additional share purchases and 4,850 million from the exchange of TIM shares. The Telecom Italia shares issued to service the exchange were valued at the market price at June 30, 2005 ( 2.595 for each ordinary share and 2.156 for each savings share).

***Reorganization of the Brazilian mobile telephone companies***

On May 30, 2005, the special shareholders' meetings of the three interested companies unanimously approved the acquisition of the shares of the minority shareholders of Tim Sul S.A. and Tim Nordeste Telecomunicações S.A. through a share capital increase effected by Tim Participações S.A.. The exchange ratios were determined on the basis of economic and equity valuations performed by Banco ABN-AMRO Real S.A.. Tim Participações effected a share capital increase on behalf of the shareholders of the two subsidiaries by issuing ordinary and preferred shares. On the same date, Tim Sul S.A. and Tim Nordeste Telecomunicações S.A. were delisted from the Brazilian stock exchange and Tim Participações then cancelled the shares purchased from the shareholders which exercised the right of withdrawal. The two companies, although maintaining separate legal and administrative status, are now wholly-owned subsidiaries of Tim Participações.

The effect on Goodwill was as follows:

- an increase of 62 million for the purchase of the shares of the minority shareholders of Tim Sul S.A. and Tim Nordeste Telecomunicações S.A. through the capital increase set aside for them and effected by the parent Tim Participações S.A. ( 57 million) and for the purchase of Tim Participações S.A. ordinary shares on the market by the parent Tim Brasil Serviços e Participações S.A. ( 5 million);
- a decrease of 25 million for the derecognition of goodwill as a result of the dilution of the investment in Tim Participações S.A. following the capital increase set aside for the minority shareholders.

The goodwill of 57 million for the purchase of the shares of the minority shareholders of Tim Sul S.A. and Tim Nordeste Telecomunicações S.A. was calculated as the difference between the market value of ordinary and preferred shares, at the transaction date, issued by Tim Participações S.A. to the minority shareholders of Tim Sul S.A. and Tim Nordeste Telecomunicações S.A. ( 204 million), and equity attributable to minority interests of Tim Sul S.A. and Tim Nordeste



Telecomunicações S.A. at the time of the transaction and covered by the acquisition ( 147 million).

The transaction had a negative effect of 14 million on the equity attributable to equity holders of the Parent and a positive effect of 40 million on the equity attributable to minority interests.

**YEAR 2004**

***Acquisition of a 40% stake in Finanziaria Web***

At the end of June 2004, an agreement was reached to settle the dispute concerning the framework agreement signed on September 20, 2000 between Seat Pagine Gialle S.p.A. (now Telecom Italia Media) and its subsidiaries, and the companies in the De Agostini group.

Based on the agreement, De Agostini Invest transferred the entire investment held in Finanziaria Web to Telecom Italia Media (which already had control of the company with a 60% holding) for cash consideration of 287 million, in lieu of the originally agreed price of 700 million.

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In addition to this amount, 38 million was paid to reimburse De Agostini Invest for the amounts paid to cover losses and recapitalize Finanziaria Web since July 2001.

The effect on the statement of income of the Telecom Italia Group was an impairment loss of 116 million net of taxes.

Finanziaria Web was merged with and into Telecom Italia as of December 31, 2005.

***Acquisition of Digital Venezuela shares***

With regard to the numerous disputes pending between Tim International and the other shareholders in Digital Venezuela, related to the coverage of the losses incurred in 2002, a settlement agreement was reached in April 2004 wherein Tim International agreed to purchase all the other shareholders stakes (corresponding to 32.88% of Digital Venezuela'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 verification of the contractual conditions put into place to protect Tim International and Digital Venezuela.

As a result, since July 1, 2004, Tim International held 100% of the shares of the Venezuelan mobile operator.

In May 2006 the entire investment in Digital Venezuela was disposed of.

**TRANSACTIONS BETWEEN COMPANIES UNDER COMMON CONTROL**

**YEAR 2006**

***Reorganization of the Brazilian mobile telephone companies***

In June 2006, the Tim Brasil group concluded the reorganization of its corporate structure, after which, Tim Brasil Serviços e Participações S.A., which previously held a 100% stake in Tim Celular S.A. and a 19.88% economic interest in Tim Participações S.A., now has a 69.66% economic interest in the new Tim Participações S.A.

The reorganization took place in the following stages:

- in March 2006:
  - Tim Celular S.A. merged the wholly-owned subsidiaries Blah! Sociedade Anonima de Servicos e Comercio and CRC Centro de Relacionamento com Clientes;
  - Tim Brasil Serviços e Participações S.A. conferred the Tim Celular S.A. shares to Tim Participações S.A. in exchange for a reserved capital increase, raising its controlling stake in Tim Participações S.A. from 50.33% to 81.19%. The transaction was recorded at book value since it was carried out within the same group and gave rise to a reduction in the equity attributable to equity holders of the parent of 59 million with an increase of the same amount in the equity attributable to minority interests;
- in June 2006, Tim Sul S.A. was merged in Tim Celular S.A and Tim Nordeste Telecomunicações S.A. was merged in Maxitel S.A., which changed its name to Tim Nordeste S.A.

#### YEAR 2005

##### ***Acquisition of Virgilio and Tin.it by Telecom Italia S.p.A.***

As part of the process to reorganize the Telecom Italia Group's Internet operations, the following transactions were finalized on the basis of the contractual agreements signed with Telecom Italia Media in 2005:

- on May 30, 2005, Telecom Italia purchased, from Telecom Italia Finance, the entire investment in ISM S.r.l. (which already held a 40% stake in Finanziaria Web which, in turn, held a 66% interest in Matrix) for a total amount of 98 million;

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- on June 1, 2005, ISM S.r.l. (in which Telecom Italia holds a 100% interest), after having received a payment for an increase of share capital from Telecom Italia for 70 million, acquired 60% of Finanziaria Web and 0.7% of Matrix from Telecom Italia Media for 70 million;
- on June 1, 2005, Telecom Italia purchased a 100% interest in Nuova Tin.it S.r.l., a newly-established company in which Telecom Italia Media contributed the Tin.it business segment, at a price of 880 million.

At the conclusion of the foregoing transactions, Telecom Italia S.p.A. holds, directly or indirectly (through ISM), full control over Virgilio's operations.

In June 2005, Telecom Italia Media successfully concluded the buyback of 364,251,922 ordinary shares and 6,107,723 savings shares (in execution of the resolution passed by the shareholders' meeting of Telecom Italia Media held on May 24, 2005) for a total amount of 148 million.

Following the cancellation of the shares on October 18, 2005, Telecom Italia S.p.A. increased its direct controlling interest (60.2%) and indirect holding (2.1% through Telecom Italia Finance) from a total of 62.3% to 69.2%. The percentage investment in share capital, also taking into account the stock options exercised, increased from 61.47% to 68.07% at December 31, 2005.

***Reorganization of the Med Group***

In July 2005, the Telecom Italia Group executed the agreement reached in December 2004 with the minority shareholders of Med Nautilus S.A., Med Nautilus Ltd and Med 1, negotiated to resolve certain matters disputed concerning Med Nautilus S.A.'s and Telecom Italia/Telecom Italia International's put option on 49% of the shares of Med Nautilus Ltd and Med 1, and to resolve the arbitration proceedings set in motion in Luxembourg by the Fishman group (FTT) aimed at the restitution of the sums paid to Telecom Italia International N.V. in 2000 for the purchase of a 30% stake in Med Nautilus S.A..

This agreement allows the Telecom Italia Group to strengthen its presence in the sector of IP services and wholesale data in the East Mediterranean and to now hold 100% stakes in Med Nautilus Ltd (through Med Nautilus S.A.) and in Med 1, following the purchase of the minority stake for consideration of 135 million.

Concurrently, non-strategic activities in certain local Israeli operations were sold which were managed by the same Med Nautilus Ltd and Med 1 (for the latter, the entire investment in Med 1 IC-1 (1999) Ltd was sold). Furthermore, the Fishman group, in disposing of its investment in Med Nautilus S.A., acquired 30% of the capital of the subsidiary Elettra S.p.A. for consideration of approximately 35 million.

Overall, the agreement entailed a net disbursement of 49 million.

**YEAR 2004**

In 2004, there were no transactions between companies under common control.

**NOTE 4 FINANCIAL RISK MANAGEMENT**

***Objectives and policies for the management of the financial risks of the Telecom Italia Group***

The Telecom Italia Group is exposed to the following financial risks during the ordinary course of its business operations:

- *market risk*: stemming from changes in interest rates and exchange rates in connection with financial activities that have been originated and financial liabilities that have been assumed;
- *credit risk*: represented by the risk of the non-fulfillment of the obligations undertaken by the counterpart with respect to the Group's investment of liquidity;
- *liquidity risk*: connected with the need to meet short-term financial commitments.

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These financial risks are managed through:

- the establishment, at a central level, of guidelines for financial operations;
- the activities of an internal committee which monitors the level of exposure to market risks in accordance with pre-established general objectives;
- the identification of the most suitable financial instruments, including derivatives, to achieve the pre-established objectives;
- the monitoring of the financial performance;
- the exclusion of the use of financial instruments for speculative purposes.

The policies for the management of the above financial risks by the Telecom Italia Group are described below.

***Market risk***

The Telecom Italia Group is exposed to market risks as a result of changes in interest rates and exchange rates in the markets in which it operates or is present with bond issues, mainly Europe, the United States, Great Britain and Latin America.

The risk management policies of the Telecom Italia Group aim to diversify market risks and minimize interest rate exposure by suitable portfolio diversification, which is also implemented by using carefully selected derivative financial instruments.

The Group defines an optimum fixed-rate and floating-rate debt composition and uses derivative financial instruments to achieve that prefixed composition. Taking into account the Group's operations in various sectors, in terms of risk, volatility and the amount of expected operating cash flows, the optimum blend of medium/long-term non-current financial liabilities has been established at 70% for the fixed-rate component and 30% for the floating-rate component.

The Group mainly uses derivative financial instruments to manage market risks:

- Interest Rate Swaps (IRS) are used to modify the profile of the original exposure to interest rate risks on loans and bonds, whether fixed or floating;

- Cross Currency and Interest Rate Swaps (CCIRS) and Currency Forwards are used to convert loans and bonds issued in currencies other than the euro principally in U.S. dollars and British pounds to the functional currencies of the operating companies.

As a result of the above policies, at December 31, 2006, the exchange rate risk on the financial payables assumed by the Group denominated in currencies other than Euro is completely hedged.

Derivative financial instruments are used by the Group and are designated as fair value hedges for the management of exchange rate risks on instruments denominated in currencies other than euro and the management of the interest rate risk on fixed-rate loans. Derivative financial instruments are designated as cash flow hedges when the objective is to fix the exchange rate of future transactions and the interest rate.

All derivative financial instruments are with high-credit-quality banking and financial counterparties with a high rating.

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The following tables present the nominal repayment/investment amount (insofar as that amount expresses the effective interest rate exposure of the Group) and, as far as financial assets are concerned, account was taken of the intrinsic nature of the transactions under consideration (financial characteristics and duration) rather than the stated contractual terms alone. Transactions with short term characteristics and frequent renewals, such that the interest rate is periodically re-fixed on the basis of market parameters (such as in the case of bank deposits and euro commercial paper), have been included in the category of floating rate, even though the contract does not call for re-fixing the interest rate.

**Financial liabilities (at the nominal repayment amount)**

|   | As of December 31, 2006 |               |               | As of December 31, 2005 |               |               |
|---|-------------------------|---------------|---------------|-------------------------|---------------|---------------|
|   | Fixed rate              | Floating rate | Total         | Fixed rate              | Floating rate | Total         |
|   | (millions of Euro)      |               |               |                         |               |               |
| Notes and bonds   | 23,101                  | 10,018        | 33,119        | 24,511                  | 10,066        | 34,577        |
| Convertible/exchangeable notes and bonds                            | 574                     |               | 574           | 2,642                   |               | 2,642         |
| Loans and other payables  | 7,167                   | 3,979         | 11,146        | 5,434                   | 7,644         | 13,078        |
| Liabilities related to discontinued operations/assets held for sale |                         |               |               |                         | 112           | 112           |
| <b>Total</b>  | <b>30,842</b>           | <b>13,997</b> | <b>44,839</b> | <b>32,587</b>           | <b>17,822</b> | <b>50,409</b> |

**Financial assets (at the nominal investment amount)**

|  | As of December 31, 2006 |               |              | As of December 31, 2005 |               |               |
|--|-------------------------|---------------|--------------|-------------------------|---------------|---------------|
|  | Fixed rate              | Floating rate | Total        | Fixed rate              | Floating rate | Total         |
|  | (millions of Euro)      |               |              |                         |               |               |
| Deposits and cash                            |                         | 7,204         | 7,204        |                         | 10,041        | 10,041        |
| Euro commercial paper                        |                         | 20            | 20           |                         | 326           | 326           |
| Securities                                   | 17                      | 813           | 830          | 4                       | 380           | 384           |
| Other receivables                            | 472                     | 199           | 671          | 24                      | 1,038         | 1,062         |
| Discontinued operations/assets held for sale |                         |               |              |                         | 37            | 37            |
| <b>Total</b>                                 | <b>489</b>              | <b>8,236</b>  | <b>8,725</b> | <b>28</b>               | <b>11,822</b> | <b>11,850</b> |

For floating-rate financial instruments, the contracts provide for revisions of the interest rate within the next 12 months.

For the categories where the effective interest rate can be determined, the effective interest rate represents the original rate net of the effect of any related derivative hedging instruments.



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The adjusted carrying amount for each class of financial assets and liabilities, was determined, for purposes of calculating the weighted average effective interest rate. The adjusted carrying amount of financial assets and liabilities includes accruals and fair value adjustments representing the amortized cost, net of accruals and any fair value adjustments as a consequence of hedge accounting.

**Financial liabilities**

|  | As of December 31, 2006  |                         | As of December 31, 2005  |                         |
|--|--------------------------|-------------------------|--------------------------|-------------------------|
|  | Adjusted carrying amount | Effective interest rate | Adjusted carrying amount | Effective interest rate |
|  | (millions of Euro)       | (%)                     | (millions of Euro)       | (%)                     |
| Notes and bonds                              | 33,037                   | 5.81%                   | 34,453                   | 5.71%                   |
| Convertible and exchangeable notes and bonds | 482                      | 7.43%                   | 2,505                    | 6.39%                   |
| Loans and other payables                     | 10,152                   | 5.24%                   | 12,891                   | 3.93%                   |
| <b>Total</b>                                 | <b>43,671</b>            | <b>5.70%</b>            | <b>49,849</b>            | <b>5.28%</b>            |

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|                       | As of December 31, 2006  |                         | As of December 31, 2005  |                         |
|-----------------------|--------------------------|-------------------------|--------------------------|-------------------------|
|                       | Adjusted carrying amount | Effective interest rate | Adjusted carrying amount | Effective interest rate |
|                       | (millions of Euro)       | (%)                     | (millions of Euro)       | (%)                     |
| Deposits and cash     | 7,204                    | 3.82%                   | 10,041                   | 3.03%                   |
| Euro commercial paper | 20                       | 3.65%                   | 326                      | 2.36%                   |
| Securities            | 830                      | 4.81%                   | 384                      | 3.29%                   |
| Other receivables     | 617                      | 5.45%                   | 864                      | 4.89%                   |
| <b>Total</b>          | <b>8,671</b>             | <b>4.03%</b>            | <b>11,615</b>            | <b>3.16%</b>            |

Hedges of financial liabilities at December 31, 2006 reduce, overall, result in a reduction of the nominal interest rate of the position and, therefore, reduce the effective interest rate.

The weighted average effective interest rate of financial assets is not essentially affected by the existence of derivative instruments.

With respect to market risk, in the broad sense, certain of the Group's debt instruments include interest coupon step-ups and step-downs when there are changes in the rating. Such mechanisms, however, do not affect interest rate exposure, as previously described above, or the determination of the current effective interest rate. Additional information is provided in the Note 18 Financial liabilities current and non-current.

As for market risk management using derivative financial instruments, reference should be made to the Note 24 Financial instruments.

**Credit risk**

The management of the liquidity of the Group is guided by prudent criteria and is principally based on the following:

- money market management, dealing with the investment of temporary excess cash resources during the year which are expected to turn around within the subsequent 12-month period;

- bond portfolio management, dealing with the investment of a permanent level of liquidity which is expected to be used for cash requirement purposes subsequent to a period of 12 months, in addition to the improvement of the average return.

In order to limit the risk of the non-fulfillment of obligations assumed by the counterparty, deposits are made with leading high-credit-quality banking and financial institutions that have credit ratings of not less than A- assigned by Standard & Poor's or an equivalent level assigned by other agencies, and are for periods of less than 3 months. As for temporary investments of liquidity in euro commercial paper, the issuers all have credit ratings of not less than A- assigned by Standard & Poor's or an equivalent level assigned by other agencies, and headquarters in Europe. With regard to bond portfolio management, the issuers have credit ratings of not less than A- assigned by Standard & Poor's or an equivalent level assigned by other agencies.

With a view towards minimizing credit risk, the Group pursues a diversification policy for its investments in liquidity and, as a result, there are no significant positions with any one single counterpart.

### ***Liquidity risk***

The Group's objective is to achieve an adequate level of financial flexibility by maintaining a margin of current treasury resources to cover refinancing requirements for at least the next 12 months using irrevocable bank lines and liquidity.

Current financial assets at December 31, 2006 represent 149.7% of short-term financial commitments (due in 2007), guaranteeing a further coverage of the maturities due in 2008.

12.2% of gross financial debt at December 31, 2006 will fall due in the following 12 months.

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In order to determine the fair value of derivative instruments, the Telecom Italia Group uses various valuation models.

The fair value of IRSs and CCIRSs reflects the difference between the fixed rate which should be paid/received and the market interest rate (having the same maturity as the swap) at the measurement date.

The notional amount of the IRSs does not represent the amount exchanged between the parties and therefore does not constitute a measurement of credit risk exposure which, instead, is limited to the amount of the differential between the interest rates paid/received.

The fair value of CCIRSs also depends on the differential between the reference exchange rate at the date of signing the contract and the exchange rate at the date of measurement, since CCIRSs imply the exchange of the reference principal, in the respective currencies of denomination, in addition to the exchange of flows of interest at the maturity date and eventually at the intermediate payment dates.

With regard to the fair value measurement of financial liabilities, reference should be made to Note 24 Financial instruments for the assumptions and the amounts.

**NOTE 5 GOODWILL**

**Goodwill** decreased by 241 million to 43,739 million compared to 43,980 million at December 31, 2005. Details of goodwill by business segment and the changes during 2005 and 2006 are presented in the following tables:

|                     | As of<br>December 31,<br>2004 | Discontinued<br>operations/<br>assets held<br>for sale | Increases          | Decreases | Exchange<br>differences | As of<br>December 31,<br>2005 |
|---------------------|-------------------------------|--|--------------------|-----------|-------------------------|-------------------------------|
|                     |                               |  | (millions of Euro) |           |                         |                               |
| Wireline            | 15,113                        |  | 254                | (3)       |                         | 15,364                        |
| Domestic Mobile     | 11,467                        |  | 15,479             |           |                         | 26,946                        |
| Brazil Mobile       | 23                            |  | 1,039              | (25)      | 185                     | 1,222                         |
| Media               | 199                           | (20)   | 58                 | (7)       |                         | 230                           |
| Olivetti            | 6                             |  |                    | (6)       |                         |                               |
| Other activities(*) | 651                           | (645)  | 198                |           | 14                      | 218                           |

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|                     | 27,459               | (665)  | 17,028    | (41)         | 199                     | 43,980                        |
|---------------------|----------------------|--|-----------|--------------|-------------------------|-------------------------------|
|                     | As of                | Discontinued<br>operations/<br>assets held<br>for sale | Increases | Decreases    | Exchange<br>differences | As of<br>December 31,<br>2006 |
|                     | December 31,<br>2005 |  |           |              |                         |                               |
|                     | (millions of Euro)   |  |           |              |                         |                               |
| Wireline            | 15,364               |  |           |              |                         | 15,364                        |
| Domestic Mobile     | 26,946               |  |           |              |                         | 26,946                        |
| Brazil Mobile       | 1,222                |  |           |              | (23)                    | 1,199                         |
| Media               | 230                  |  |           |              |                         | 230                           |
| Other activities(*) | 218                  |  |           | (184)        | (34)                    |                               |
| <b>Total</b>        | <b>43,980</b>        |  |           | <b>(184)</b> | <b>(57)</b>             | <b>43,739</b>                 |

(\*) Other activities include, respectively, the Finsiel group, the Entel Chile group and Tim Hellas which were sold during 2005 and Avea I.H.A.S. which was sold in 2006.

The decrease of 241 million in 2006 is due to the following transactions:

- 218 million related to the sale of Avea I.H.A.S.;
- 23 million for exchange differences on the goodwill relating to the Brazilian companies.

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The gross carrying amounts of goodwill and the relative impairment losses accumulated from January 1, 2004 (date of allocation to the Cash-Generating Units CGU) to December 31, 2006 and 2005 can be summarized as follows:

|                     | As of December 31, 2006 |                               |                     | As of December 31, 2005 |                               |                     |
|---------------------|-------------------------|-------------------------------|---------------------|-------------------------|-------------------------------|---------------------|
|                     | Gross carrying amount   | Accumulated impairment losses | Net carrying amount | Gross carrying amount   | Accumulated impairment losses | Net carrying amount |
|                     | (millions of Euro)      |                               |                     |                         |                               |                     |
| Wireline            | (**)15,656              | (**)(292)                     | 15,364              | (**)15,656              | (**)(292)                     | 15,364              |
| Domestic Mobile     | 26,946                  |                               | 26,946              | 26,946                  |                               | 26,946              |
| Brazil Mobile       | 1,206                   | (7)                           | 1,199               | 1,229                   | (7)                           | 1,222               |
| Media               | 230                     |                               | 230                 | 230                     |                               | 230                 |
| Olivetti            | 6                       | (6)                           |                     | 6                       | (6)                           |                     |
| Other activities(*) |                         |                               |                     | 218                     |                               | 218                 |
| <b>Total</b>        | <b>44,044</b>           | <b>(305)</b>                  | <b>43,739</b>       | <b>44,285</b>           | <b>(305)</b>                  | <b>43,980</b>       |

(\*) Other activities include Avea I.H.A.S. which was sold in 2006.

(\*\*) Includes 282 million relating to the settlement with De Agostini in 2004.

Goodwill under IAS 36 is not amortized but is tested for impairment annually or more frequently if specific events or circumstances indicate that it may be impaired. To test for impairment, goodwill must be allocated to cash-generating units or groups of cash-generating units which must not be at a higher level than the business segment determined in accordance with IAS 14. The criteria followed for the allocation of goodwill considers the lowest level at which goodwill is monitored for internal management purposes. The business units (or groups of units) to which goodwill was allocated are as follows:

| Sector   | Group of units  |
|----------|---|
| Wireline | Liberty Surf<br>Hansenet<br>Wireline (excluded Liberty Surf and Hansenet) |
| Mobile   | Domestic<br>Brazil  |
| Media    | Telecom Italia Media  |

The value used to determine the recoverable amount of the units (or groups of units) to which the goodwill was allocated is the value in use, except for Liberty Surf, for which fair value was used net of costs to sell (estimated on the basis of multiples of comparable companies), and for Telecom Italia Media, for which market capitalization at December 31, 2006 was used as the fair value of the entity.

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The most representative basic assumptions for the calculation of the value in use of each group of cash generating units are presented in the following table:

| <b>Hansenet</b>        | <b>Wireline</b>   | <b>Domestic Mobile</b>   | <b>Brazil Mobile</b>   |
|------------------------|---|--|--|
| Number of customers    | Ebitda margin (Ebitda/sales) during the period of the plan  | Ebitda margin (Ebitda/sales) during the period of the plan         | Growth rate of sales during the explicit forecast period (2007-2009) |
| Gross operating margin | Investments to maintain profit capability (in proportion to sales)  | Investments to maintain profit capability (in proportion to sales) | Ebitda margin (Ebitda/sales) during the period of the plan           |
|                        | Non-recurring expenses excluded from expected Ebitda for extrapolation in the calculation of the end amount |  | Exchange rate Real Brazilian/Euro                                    |
| Cost of capital        | Cost of capital   | Cost of capital  | Cost of capital  |
| Long-term growth rate  | Long-term growth rate   | Long-term growth rate  | Long-term growth rate  |

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All the plan figures are based on the actual results for 2006 and rely on the management forecasts for the period of the 2007/2009 plan.

For Hansenet, in order to exclude the net present value of future investments in the impairment test (IAS 36, paragraph 44), only the flow of the expected result for 2007 was considered, forecasting it in perpetuity.

The recoverable amount of Liberty Surf was assumed to be equal to fair value less costs to sell, which is higher than the value in use which was calculated without considering the net present value of future investments for network development.

The nominal growth rates used to estimate the end amount are the following (the growth rate of Brazil refers to flows in Brazilian Reais):

| <u>Hansenet</u> | <u>Wireline</u> | <u>Domestic Mobile</u> | <u>Brazil Mobile</u> |
|-----------------|-----------------|------------------------|----------------------|
| +0.5%           | 0%              | +0.5%                  | +6.55%               |

Such rates fall within the range of growth rates applied by the analysts following Telecom Italia stock (as can be seen from the reports published after the announcement of the third-quarter 2006 results).

The cost of capital was estimated by considering the following:

- the CAPM Capital Asset Pricing Model to estimate the value in use and referred to in Annex A of IAS 36;
- the Beta coefficient for business segments obtained by using the Beta coefficients of the European telephone incumbents, including Telecom Italia itself, adjusted to take into account the financial structure;
- the WACC Weighted Average Cost of Capital used by other operators to test the value of goodwill;
- the WACC Weighted Average Cost of Capital used by the analysts following Telecom Italia stock in the reports published after the announcement of third-quarter 2006 results relative to the principal business segments of the Group. Since there is a direct correlation between the cost of capital used by the analysts and the long-term growth rate (g) forecast for the purpose of estimating the end amount, the comparison was also made on the capitalization rates (WACC-g).

On the basis of these elements, the post-tax Weighted Average Cost of Capital and the capitalization rate (WACC after taxes g) were estimated for each business unit (Reais are used for Brazil) as follows:



|                     | <u>Hansenet</u> | <u>Wireline</u> | <u>Domestic Mobile</u> | <u>Brazil Mobile</u> |
|---------------------|-----------------|-----------------|------------------------|----------------------|
| Wacc after taxes    | 7.6%            | 6.8%            | 7.0%                   | 13.5%                |
| Wacc after taxes -g | 7.1%            | 6.8%            | 6.5%                   | 7.0%                 |

Having considered the nominal flows of the result for the estimate of the value in use, the discount rates are also expressed in nominal terms (in Reais for Brazil).

A sensitivity analysis of the results was also carried out for those units for which the value in use was estimated: in all cases the value in use remains higher than the carrying amounts, even assuming an increase in the weighted average cost of capital of 50 basis point (hundredths of a percentage point).

The second level of impairment testing was carried out by comparing the total recoverable value of all the business units of the Group, including those without any goodwill allocation (Olivetti, Bolivia, Central Functions and Other activities) to the carrying amount of total operating capital of the Group. This second level of test did not show any impairment.

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**Intangible assets with a finite life** decreased from 6,810 million at December 31, 2005 to 6,740 million. Details on the composition and movements during the year are as follows:

|  | As of<br>December 31,<br>2004 | Discontinued<br>Operations/<br>assets held<br>for sale | Additions    | Amortization   | Impairment<br>losses/<br>Reversals | Disposals   | Exchange<br>differences | Other<br>changes | As of<br>December 31,<br>2005 |
|--|-------------------------------|--|--------------|----------------|------------------------------------|-------------|-------------------------|------------------|-------------------------------|
| (millions of Euro)                                   |                               |  |              |                |                                    |             |                         |                  |                               |
| Industrial patents and intellectual property rights  | 2,510                         | (99)   | 1,276        | (1,414)        | (10)                               | (20)        | 91                      | 476              | 2,810                         |
| Concessions, licenses, trademarks and similar rights | 3,504                         | (365)  | 51           | (253)          |                                    | (6)         | 188                     | 199              | 3,318                         |
| Other intangible assets                              | 52                            | (16)   | 47           | (17)           |                                    |             |                         | (9)              | 57                            |
| Work in progress and advance payments                | 708                           | (14)   | 411          |                |                                    |             | 18                      | (498)            | 625                           |
| <b>Total</b>   | <b>6,774</b>                  | <b>(494)</b>   | <b>1,785</b> | <b>(1,684)</b> | <b>(10)</b>                        | <b>(26)</b> | <b>297</b>              | <b>168</b>       | <b>6,810</b>                  |

|  | As of<br>December 31,<br>2005 | Discontinued<br>Operations/<br>assets held<br>for sale | Additions | Amortization | Impairment<br>losses/<br>Reversals | Disposals | Exchange<br>differences | Other<br>changes | As of<br>December 31,<br>2006 |
|--|-------------------------------|--|-----------|--------------|------------------------------------|-----------|-------------------------|------------------|-------------------------------|
| (millions of Euro)                                   |                               |  |           |              |                                    |           |                         |                  |                               |
| Industrial patents and intellectual property rights  | 2,810                         |  | 1,126     | (1,760)      |                                    |           | (9)                     | 454              | 2,621                         |
| Concessions, licenses, trademarks and similar rights | 3,318                         |  | 184       | (310)        | (14)                               | (7)       | (19)                    | 20               | 3,172                         |
| Other intangible                                     | 57                            |  | 260       | (110)        |                                    |           | (1)                     | (30)             | 176                           |

|                                      |              |              |                |             |            |             |             |              |
|--------------------------------------|--------------|--------------|----------------|-------------|------------|-------------|-------------|--------------|
| assets                               |              |              |                |             |            |             |             |              |
| Work in progress and advance payment | 625          | 617          | (1)            | (1)         | (1)        | (468)       | 771         |              |
| <b>Total</b>                         | <b>6,810</b> | <b>2,187</b> | <b>(2,180)</b> | <b>(15)</b> | <b>(8)</b> | <b>(30)</b> | <b>(24)</b> | <b>6,740</b> |

Additions made during 2006 include 318 million of internal costs capitalized ( 287 million in 2005).

**Industrial patents and intellectual property rights** at December 31, 2006 consist almost entirely of applications software purchased outright and user license rights acquired for an indefinite time period (amortized over the period of useful benefit estimated in three years). They mainly refer to the Wireline Business Unit ( 1,290 million), the Mobile Domestic Business Unit ( 774 million) and the Brazil Mobile Business Unit ( 441 million).

**Concessions, licenses, trademarks and similar rights** at December 31, 2006 mainly refer to the Domestic Mobile Business Unit ( 2,025 million) and the Brazil Mobile Business Unit ( 618 million) with respect to the remaining unamortized cost of UMTS and PCS licenses, to the Wireline Business Unit ( 375 million, of which 131 million refers to costs for Indefeasible Rights of Use-IRU) and to the Media Business Unit ( 150 million, mainly for TV frequencies acquired at the end of 2005).

The remaining unamortized mobile telephone licenses totaling 2,643 million (amortized on a straight line basis) refer to the following:

- licenses of Telecom Italia S.p.A.:

UMTS for 2,014 million expiring in 2021 (amortized over 18 years);

Wireless Local Loop for 11 million expiring in 2021 (amortized over 15 years);

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- licenses of the Tim Participações group:

GSM for 495 million expiring between 2007 and 2018 (amortized in 4-15 years);

TDMA for 123 million expiring in 2012 (amortized in about 14 years).

The user rights for televisions frequencies totaling 144 million are amortized as follows: if used for analog broadcasting, amortization is taken to December 31, 2008; if used for digital terrestrial broadcasting, amortization is taken until 2018, the period (12 years) of the network operator license for which the request was filed in the first half of 2006.

**Other intangible assets** at December 31, 2006 include 160 million for the capitalization of subscriber acquisition costs referring to the new sales offers of Telecom Italia S.p.A. (96 million), the Tim Brasil group (57 million) and Liberty Surf Group S.A. (7 million). Following the introduction of new types of sales contracts in 2006 which bind the customer to the Telecom Italia Group for periods of 12 or 24 months, otherwise a penalty is applied, the Group capitalized subscriber acquisition costs in intangible assets. These costs represent negative margins on handset sales and commissions for the sales network. This accounting treatment, permitted by IAS 38 makes it possible to match the amortization charge with cash flows.

Other intangible assets also include 9 million allocated to the Customer List and representing a portion of the goodwill that arose on the acquisition of the controlling interest in Liberty Surf Group S.A..

In 2006, the impairment losses of 15 million mainly refer to Latin American Nautilus group. In 2005, the impairment losses of 10 million, net of impairment reversals of 1 million, mainly referred to Maxitel (now renamed Tim Nordeste S.A.).

Amortization and impairment losses are recorded in the statement of income as components of the operating result.

The gross carrying amount, accumulated impairment losses and accumulated amortization at December 31, 2006 and 2005 can be summarized as follows:

|   | <b>As of December 31, 2006</b>       |  |                                     |                                    |
|---|--------------------------------------|--|-------------------------------------|------------------------------------|
|   | <b>Gross<br/>carrying<br/>amount</b> | <b>Accumulated<br/>impairment<br/>losses</b> | <b>Accumulated<br/>amortization</b> | <b>Net<br/>carrying<br/>amount</b> |
|   | (millions of Euro)                   |  |                                     |                                    |
| Industrial patents and intellectual property rights | 11,806                               | (8)  | (9,177)                             | 2,621                              |

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|  |               |              |                 |              |
|--|---------------|--------------|-----------------|--------------|
| Concessions, licenses, trademarks and similar rights | 4,595         | (262)        | (1,161)         | 3,172        |
| Other intangible assets                              | 424           | (75)         | (173)           | 176          |
| Work in progress and advance payments                | 772           | (1)          |                 | 771          |
| <b>Total</b>   | <b>17,597</b> | <b>(346)</b> | <b>(10,511)</b> | <b>6,740</b> |

As of December 31, 2005

|  | Gross carrying amount | Accumulated impairment losses | Accumulated amortization | Net carrying amount |
|--|-----------------------|-------------------------------|--------------------------|---------------------|
|  | (millions of Euro)    |                               |                          |                     |
| Industrial patents and intellectual property rights  | 9,886                 | (8)                           | (7,068)                  | 2,810               |
| Concessions, licenses, trademarks and similar rights | 4,457                 | (276)                         | (863)                    | 3,318               |
| Other intangible assets                              | 170                   | (80)                          | (33)                     | 57                  |
| Work in progress and advance payments                | 625                   |                               |                          | 625                 |
| <b>Total</b>   | <b>15,138</b>         | <b>(364)</b>                  | <b>(7,964)</b>           | <b>6,810</b>        |

The impairment losses in Concessions, licenses, trademarks and similar rights mainly refer to the Indefeasible Rights of Use IRU of the transmission capacity and cables relating to the international connections acquired by the Latin American Nautilus group.

Such impairments, principally relating to the years prior to 2004, are the result of the altered and shrunken market value of international broadband compared to the expectations anticipated at the historical date of those investments.

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Property, plant and equipment owned decreased from 16,443 million at December 31, 2005 to 15,690 million. Details on the composition and movements during the years 2006 and 2005 are as follows:

|  | <b>As of<br/>December 31,<br/>2004</b> | <b>Discontinued<br/>operations/<br/>assets held<br/>for sale</b> | <b>Additions</b> | <b>Depreciation</b> | <b>Impairment<br/>losses/<br/>Reversals</b> | <b>Disposals</b> | <b>Exchange<br/>differences</b> | <b>Other<br/>changes</b> | <b>As of<br/>December 31,<br/>2005</b> |
|--|--|--|------------------|---------------------|---|------------------|---------------------------------|--------------------------|--|
| <b>(millions of Euro)</b>                |  |  |                  |                     |   |                  |                                 |                          |  |
| Land                                     | 224                                    | (14)   |                  |                     |   | (62)             | 2                               | 5                        | 155                                    |
| Civil and industrial buildings           | 1,458                                  | (181)  | 23               | (103)               | (1)   | (249)            | 19                              | 6                        | 972                                    |
| Plant and equipment                      | 14,150                                 | (1,219)  | 2,069            | (2,910)             |   | (29)             | 378                             | 468                      | 12,907                                 |
| Manufacturing and distribution equipment | 62                                     | (5)  | 38               | (31)                |   |                  |                                 | 8                        | 72                                     |
| Aircrafts and ships                      | 55                                     |  |                  | (9)                 |   |                  |                                 |                          | 46                                     |
| Other                                    | 962                                    | (86)   | 380              | (363)               |   | (6)              | 99                              | 188                      | 1,174                                  |
| Work in progress and advance payments    | 942                                    | (77)   | 790              |                     | (8)   | (2)              | 59                              | (587)                    | 1,117                                  |
| <b>Total</b>                             | <b>17,853</b>                          | <b>(1,582)</b>   | <b>3,300</b>     | <b>(3,416)</b>      | <b>(9)</b>                                  | <b>(348)</b>     | <b>557</b>                      | <b>88</b>                | <b>16,443</b>                          |

|  | <b>As of<br/>December 31,<br/>2005</b> | <b>Discontinued<br/>operations/<br/>assets held<br/>for sale</b> | <b>Additions</b> | <b>Depreciation</b> | <b>Impairment<br/>losses/<br/>Reversals</b> | <b>Disposals</b> | <b>Exchange<br/>differences</b> | <b>Other<br/>changes</b> | <b>As of<br/>December 31,<br/>2006</b> |
|--|--|--|------------------|---------------------|---|------------------|---------------------------------|--------------------------|--|
| <b>(millions of Euro)</b>                |  |  |                  |                     |   |                  |                                 |                          |  |
| Land                                     | 155                                    |  |                  |                     |   | (3)              | (1)                             | (17)                     | 134                                    |
| Civil and industrial buildings           | 972                                    |  | 9                | (48)                |   | (195)            | (3)                             | (137)                    | 598                                    |
| Plant and equipment                      | 12,907                                 |  | 2,206            | (2,644)             | (3)   | (23)             | (68)                            | 580                      | 12,955                                 |
| Manufacturing and distribution equipment | 72                                     |  | 17               | (33)                | (1)   |                  |                                 | 4                        | 59                                     |

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|                                       |               |              |                |            |              |             |              |               |
|---------------------------------------|---------------|--------------|----------------|------------|--------------|-------------|--------------|---------------|
| Aircrafts and ships                   | 46            | 1            | (7)            |            |              |             |              | 40            |
| Other                                 | 1,174         | 190          | (446)          | (3)        | (7)          | 108         |              | 1,016         |
| Work in progress and advance payments | 1,117         | 462          |                | (2)        | (12)         | (3)         | (674)        | 888           |
| <b>Total</b>                          | <b>16,443</b> | <b>2,885</b> | <b>(3,178)</b> | <b>(6)</b> | <b>(236)</b> | <b>(82)</b> | <b>(136)</b> | <b>15,690</b> |

Additions in 2006 include 178 million of internal costs capitalized ( 184 million in 2005).

In 2006, the impairment losses of 6 million ( 9 million in 2005) mainly refer to the writedown of telephone materials in the process of being replaced with new more advanced technological equipment.

Depreciation and impairment losses/reversals are recorded in the statement of income as components of the operating result.

In 2006, the plan was completed for the disposal of real estate properties approved by the Board of Directors on December 21, 2005 for more than 1,300 buildings for a total of approximately 1 billion.

After a first stage of the disposal plan was concluded in 2005, 291 properties were sold to Fondo Raissa and 181 to Fondo Spazio Industriale for a total amount of 350 million in March 2006, June 2006 and December 2006. The transaction generated a gross gain on consolidation of 135 million and reduced the consolidated net financial debt by 296 million before taxes.

These effects take into account the recognition, in accordance with the finance method in IAS 17, of the contribution of 45 properties to Fondo Raissa and the simultaneous long-term financial leaseback of these properties which have been reclassified from properties owned to properties held under finance leases.

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Other changes include not only properties sold and simultaneously leased back for 30 million but the revision of the estimates for the restoring costs of the Tim Brasil group for 105 million. The change in estimate is due to a reduction in the unit cost for restoring the sites achieved following the renewal of contracts with foreign suppliers, subsequent to the reorganization of the company, and also greater use of co-siting contracts which do not require the companies to restore the sites. These changes in estimate have been recorded with a contra-entry to Provisions for risks and charges, as provided by IFRIC 1.

The gross carrying amount, accumulated impairment losses and accumulated depreciation at December 31, 2006 and 2005 can be summarized as follows:

| As of December 31, 2006                  |                             |                                     |                             |                           |
|--|-----------------------------|-------------------------------------|-----------------------------|---------------------------|
|  | Gross<br>carrying<br>amount | Accumulated<br>impairment<br>losses | Accumulated<br>depreciation | Net<br>carrying<br>amount |
| (millions of Euro)                       |                             |                                     |                             |                           |
| Land                                     | 134                         |                                     |                             | 134                       |
| Civil and industrial buildings           | 1,333                       | (2)                                 | (733)                       | 598                       |
| Plant and equipment                      | 58,112                      | (66)                                | (45,091)                    | 12,955                    |
| Manufacturing and distribution equipment | 751                         |                                     | (692)                       | 59                        |
| Aircrafts and ships                      | 145                         | (11)                                | (94)                        | 40                        |
| Other                                    | 4,046                       | (6)                                 | (3,024)                     | 1,016                     |
| Work in progress and advance payments    | 897                         | (9)                                 |                             | 888                       |
| <b>Total</b>                             | <b>65,418</b>               | <b>(94)</b>                         | <b>(49,634)</b>             | <b>15,690</b>             |

| As of December 31, 2005                  |                             |                                     |                             |                           |
|--|-----------------------------|-------------------------------------|-----------------------------|---------------------------|
|  | Gross<br>carrying<br>amount | Accumulated<br>impairment<br>losses | Accumulated<br>depreciation | Net<br>carrying<br>amount |
| (millions of Euro)                       |                             |                                     |                             |                           |
| Land                                     | 155                         |                                     |                             | 155                       |
| Civil and industrial buildings           | 2,247                       | (35)                                | (1,240)                     | 972                       |
| Plant and equipment                      | 58,143                      | (151)                               | (45,085)                    | 12,907                    |
| Manufacturing and distribution equipment | 756                         | (5)                                 | (679)                       | 72                        |
| Aircrafts and ships                      | 145                         | (11)                                | (88)                        | 46                        |
| Other                                    | 4,159                       | (7)                                 | (2,978)                     | 1,174                     |
| Work in progress and advance payments    | 1,126                       | (9)                                 |                             | 1,117                     |
| <b>Total</b>                             | <b>66,731</b>               | <b>(218)</b>                        | <b>(50,070)</b>             | <b>16,443</b>             |



The reduction in the gross carrying amount, accumulated impairment losses and accumulated depreciation is due to the aforementioned disposal of part of the corporate buildings to real estate investment funds and the sale of network installations and other equipment that has been almost completely depreciated, also comprising, to a lesser degree, the tangible assets acquired in 2002 as a result of the merger of BLU S.p.A., which had been completely written down.

**Assets held under finance leases**

Assets held under finance leases decreased from 1,598 million at December 31, 2005 to 1,525 million. Details on the composition and changes are as follows:

|                                       | As of<br>December 31,<br>2004 | Discontinued<br>Operations/<br>assets held<br>for sale | Additions | Depreciation | Disposals  | Exchange<br>differences | Other<br>changes | As of<br>December 31,<br>2005 |
|---------------------------------------|-------------------------------|--|-----------|--------------|------------|-------------------------|------------------|-------------------------------|
| (millions of Euro)                    |                               |  |           |              |            |                         |                  |                               |
| Civil and industrial buildings        | 1,561                         | (21)   | 14        | (93)         |            |                         | 16               | 1,477                         |
| Plant and equipment                   | 1                             | (1)  |           | (1)          |            |                         | 2                | 1                             |
| Aircrafts and ships                   | 18                            |  |           | (4)          |            |                         |                  | 14                            |
| Other                                 | 73                            | (5)  | 46        | (34)         | (4)        |                         | (5)              | 71                            |
| Work in progress and advance payments |                               |  | 28        |              |            |                         | 7                | 35                            |
| <b>Total</b>                          | <b>1,653</b>                  | <b>(27)</b>  | <b>88</b> | <b>(132)</b> | <b>(4)</b> |                         | <b>20</b>        | <b>1,598</b>                  |

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|---------------------------------------|-------------------------------|--|-----------|--------------|--|-------------------------|------------------|-------------------------------|
|                                       | As of<br>December 31,<br>2005 | Discontinued<br>Operations/<br>assets held<br>for sale | Additions | Depreciation | Disposals                                  | Exchange<br>differences | Other<br>changes | As of<br>December 31,<br>2006 |
|                                       | (millions of Euro)            |  |           |              |  |                         |                  |                               |
| Civil and industrial buildings        | 1,477                         |  | 29        | (99)         | (1)  |                         | 11               | 1,417                         |
| Plant and equipment                   | 1                             |  |           | (1)          |  |                         | 1                | 1                             |
| Aircrafts and ships                   | 14                            |  |           | (4)          |  |                         |                  | 10                            |
| Other                                 | 71                            |  | 2         | (25)         |  |                         | (1)              | 47                            |
| Work in progress and advance payments | 35                            |  | 11        |              |  |                         | 4                | 50                            |
| <b>Total</b>                          | <b>1,598</b>                  |  | <b>42</b> | <b>(129)</b> | <b>(1)</b>                                 |                         | <b>15</b>        | <b>1,525</b>                  |

Depreciation and impairment losses are recorded in the statement of income as components of the operating result.

Other changes in 2006 include 30 million representing the net carrying amount of owned properties contributed to Fondo Raissa and the simultaneous long-term financial leaseback of these properties which, in accordance with IAS 17, have been reclassified from owned properties to properties held under finance leases, and 23 million due to the change in the scope of consolidation following the sale of RUF Gestion.

The gross carrying amount, accumulated impairment losses and accumulated depreciation at December 31, 2006 and 2005 can be summarized as follows:

|                                       | As of December 31, 2006     |                                     |                             |                           |
|---------------------------------------|-----------------------------|-------------------------------------|-----------------------------|---------------------------|
|                                       | Gross<br>carrying<br>amount | Accumulated<br>impairment<br>losses | Accumulated<br>depreciation | Net<br>carrying<br>amount |
|                                       | (millions of Euro)          |                                     |                             |                           |
| Civil and industrial buildings        | 1,926                       | (27)                                | (482)                       | 1,417                     |
| Plant and equipment                   | 16                          |                                     | (15)                        | 1                         |
| Aircrafts and ships                   | 30                          |                                     | (20)                        | 10                        |
| Other                                 | 160                         |                                     | (113)                       | 47                        |
| Work in progress and advance payments | 50                          |                                     |                             | 50                        |
| <b>Total</b>                          | <b>2,182</b>                | <b>(27)</b>                         | <b>(630)</b>                | <b>1,525</b>              |

| As of December 31, 2005               |                             |                                     |                             |                           |
|---------------------------------------|-----------------------------|-------------------------------------|-----------------------------|---------------------------|
|                                       | Gross<br>carrying<br>amount | Accumulated<br>impairment<br>losses | Accumulated<br>depreciation | Net<br>carrying<br>amount |
| (millions of Euro)                    |                             |                                     |                             |                           |
| Civil and industrial buildings        | 1,967                       | (27)                                | (463)                       | 1,477                     |
| Plant and equipment                   | 22                          |                                     | (21)                        | 1                         |
| Aircrafts and ships                   | 30                          |                                     | (16)                        | 14                        |
| Other                                 | 152                         |                                     | (81)                        | 71                        |
| Work in progress and advance payments | 35                          |                                     |                             | 35                        |
| <b>Total</b>                          | <b>2,206</b>                | <b>(27)</b>                         | <b>(581)</b>                | <b>1,598</b>              |

At December 31, 2006 and 2005, minimum lease payments due in future years and their present value are as follows:

| As of December 31, |                              |   |                              |   |
|--------------------|------------------------------|---|------------------------------|---|
|                    | 2006                         |   | 2005                         |   |
|                    | Minimum<br>lease<br>payments | Present<br>value of<br>minimum<br>lease<br>payments | Minimum<br>lease<br>payments | Present<br>value of<br>minimum<br>lease<br>payments |
| (millions of Euro) |                              |   |                              |   |
| Within 1 year      | 227                          | 121   | 234                          | 218   |
| From 2 to 5 years  | 819                          | 377   | 868                          | 685   |
| Beyond             | 1,841                        | 1,241   | 1,965                        | 891   |
|                    | <b>2,887</b>                 | <b>1,739</b>  | <b>3,067</b>                 | <b>1,794</b>  |

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|   | As of December 31, |              |
|---|--------------------|--------------|
|   | 2006               | 2005         |
|   | (millions of Euro) |              |
| Future lease payments (minimum lease payments)    | 2,887              | 3,067        |
| Less: Interest portion                            | (1,148)            | (1,273)      |
| <b>Present value of lease payments</b>            | <b>1,739</b>       | <b>1,794</b> |
| Finance lease liabilities                         | 2,116              | 2,128        |
| Financial receivables for lessors net investments | (377)              | (334)        |
| <b>Total net finance lease liabilities</b>        | <b>1,739</b>       | <b>1,794</b> |

**NOTE 8 OTHER NON-CURRENT ASSETS**

**Other non-current assets** amount to 3,738 million ( 5,956 million at December 31, 2005). The composition is as follows:

|   | As of December 31, |            |
|---|--------------------|------------|
|   | 2006               | 2005       |
|   | (millions of Euro) |            |
| Investments accounted for using the equity method:                        |                    |            |
| Associates  | 471                | 765        |
| Joint ventures  | 17                 | 16         |
|   | <b>488</b>         | <b>781</b> |
| Other investments   | <b>776</b>         | <b>561</b> |
| Securities, financial receivables and other non-current financial assets: |                    |            |
| Securities other than investments   | 12                 | 8          |
| Financial receivables and other non-current financial assets              | 679                | 988        |
|   | <b>691</b>         | <b>996</b> |
| Miscellaneous receivables and other non-current assets:                   |                    |            |
| Miscellaneous receivables   | 360                | 358        |
| Medium/long-term prepaid expenses   | 511                | 467        |
|   | <b>871</b>         | <b>825</b> |

|                         |              |              |
|-------------------------|--------------|--------------|
| Deferred tax assets (*) | 912          | 2,793        |
| <b>Total</b>            | <b>3,738</b> | <b>5,956</b> |

(\*) Please see Note 9 Deferred tax assets and deferred tax liabilities .

### **Major transactions involving investments**

#### **a) Acquisitions and divestitures in 2006**

##### **Sale of Avea I.H.A.S. to Türk Telekomünikasyon A.S. and additional purchase of a stake in Oger Telecom Limited**

On September 15, 2006, the sale of the 40.56% stake in Avea I.H.A.S. to Türk Telekomünikasyon A.S. was finalized for U.S.\$500 million. Moreover, as established in the July 14, 2006 agreements, Telecom Italia S.p.A. reinvested US\$250 million in the capital of Oger Telecom.

This sale reduced net financial debt by 279 million, being the balance between the proceeds on the sale ( 393 million) and the recognition of non-current financial liabilities ( 114 million) corresponding to the fair value of the commitments to provide financing or guarantee a bank loan to Avea I.H.A.S. in the amount of US\$ 150 million.

The sale resulted in a gain of 72 million and the release to income of 121 million for the remaining guarantee provisions which were cancelled during September 2006.

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**b) Acquisitions and divestitures in 2005**

**Privatization of Türk Telekomünikasyon A.S.**

On July 1, 2005, the bidding ended for the privatization of the majority stake (55%) of the Turkish telecommunications operator Türk Telekomünikasyon A.S.. The bid was won for U.S.\$6,550 million by a vehicle company controlled by Oger Telecom, a newly-formed company controlled by the Saudi-Lebanese group Saudi Oger Limited and in which Telecom Italia S.p.A. through Tim International made an initial investment of U.S.\$200 million (13.33%). The partnership between Telecom Italia S.p.A. and Saudi Oger Limited covers mobile telecommunications, while for fixed-line telecommunications Oger Telecom will continue its collaboration with BT Telconsult. The agreements with Saudi Oger also envisaged the possibility of Tim International selling its investment in Avea I.H.A.S. to Türk Telekomünikasyon A.S., which took place on September 15, 2006, as described above.

Within the next three years Oger Telecom is expected to be listed on the Dubai stock exchange with the possibility of Tim International investing proportionally in the initial placement. Should the listing not take place within the agreed timeframe, Tim International may exercise a put option to sell Saudi Oger Limited the Oger Telecom shares deriving from the sale of the current investment in Avea I.H.A.S. and also one-fourth of the Oger Telecom shares initially subscribed by Tim International. If the put option is not exercised, the counterpart may exercise a call option on the same shares.

**Acquisition of Luna Rossa Challenge 2007 S.L. and Luna Rossa Trademark S.a.r.l.**

On July 27, 2005, Telecom Italia S.p.A. acquired 49% of the share capital of Luna Rossa Challenge 2007 S.L., a Spanish-registered company, by subscribing to a share capital increase reserved for Telecom Italia S.p.A. for approximately 2 million.

On July 28, 2005, Telecom Italia purchased 49% of the share capital of Luna Rossa Trademark S.a.r.l., a Luxembourg-registered company, from Prada S.A. for 10 million.

**Sale of CMobil CZ**

Under the process for the rationalization of the international investment portfolio, on March 24, 2005, TIM finalized the sale of 7.16% of the share capital of CMobil CZ (a Dutch holding company which has a 60.8% stake in T-Mobile CZ) to T-Mobile Global Holding. This investment corresponded to an indirect interest of 4.35% in T-Mobile CZ, one of the largest mobile operators in the Czech Republic. The sales price was 70.5 million on which a gain was realized of approximately 61 million.

Investments in associates accounted for using the equity method are detailed as follows:

|                                 | As of<br>December 31,<br>2004 | Investments | Disposals and<br>capital<br>reimbursements | Valuation<br>using the<br>equity<br>method | Reclassifications<br>and other changes | As of<br>December 31,<br>2005 |
|---------------------------------|-------------------------------|-------------|--|--|--|-------------------------------|
| (millions of Euro)              |                               |             |  |  |  |                               |
| AVEA I.H.A.S.                   |                               | 122         |  | (122)                                      |  |                               |
| Brasil Telecom<br>Participações |                               |             |  | (2)  | 23                                     | 21                            |
| ETECSA.                         | 290                           |             |  | 39   |  | 329                           |
| Italtel Group                   | 32                            |             |  | 6  |  | 38                            |
| Siemens Informatica             | 14                            |             |  | (10)                                       |  | 4                             |
| Solpart Participações           |                               |             | (17)                                       | 142  | 89                                     | 214                           |
| Tiglio I                        | 153                           |             | (41)                                       | (17)                                       |  | 95                            |
| Tiglio II                       | 60                            |             | (33)                                       | (10)                                       |  | 17                            |
| Other                           | 36                            | 14          | (7)  | 4  |  | 47                            |
| <b>Total</b>                    | <b>585</b>                    | <b>136</b>  | <b>(98)</b>                                | <b>30</b>                                  | <b>112</b>                             | <b>765</b>                    |

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|                                 | Financial Statements          |             |  | Notes To Consolidated Financial Statements |  |                               |
|---------------------------------|-------------------------------|-------------|--|--|--|-------------------------------|
|                                 | As of<br>December 31,<br>2005 | Investments | Disposals and<br>capital<br>reimbursements | Valuation<br>using the<br>equity<br>method | Reclassifications<br>and other changes | As of<br>December 31,<br>2006 |
| (millions of Euro)              |                               |             |  |  |  |                               |
| Brasil Telecom<br>Participações | 21                            |             |  | 1  | (22)                                   |                               |
| ETECSA.                         | 329                           |             |  | (18)                                       |  | 311                           |
| Italtel Group                   | 38                            |             |  | 5  |  | 43                            |
| Siemens Informatica             | 4                             |             |  | (4)  |  |                               |
| Solpart Participações           | 214                           |             |  | 2  | (216)                                  |                               |
| Tiglio I                        | 95                            |             | (24)                                       | (2)  |  | 69                            |
| Tiglio II                       | 17                            |             | (11)                                       | (2)  |  | 4                             |
| Other                           | 47                            | 1           | (3)  | (1)  |  | 44                            |
| <b>Total</b>                    | <b>765</b>                    | <b>1</b>    | <b>(38)</b>                                | <b>(19)</b>                                | <b>(238)</b>                           | <b>471</b>                    |

The decrease of 294 million from December 31, 2005 mainly related to Solpart Participações and Brasil Telecom Participações.

On October 27, 2006, following approval by the Brazilian Telecommunications Authority (ANATEL), the 38% stake in Solpart Participações (the controlling holding company of Brasil Telecom Participações) was transferred to Brasilco S.r.l., a newly incorporated Italian company held by a trust set-up under British law, with Telecom Italia International as the beneficiary. The investment in Solpart Participações is now held and managed, through Brasilco S.r.l., by Credit Suisse as a trustee but Telecom Italia International will be the sole beneficiary of the trust and, consequently, of the earnings deriving from the investment in Solpart, including the price of its future sale.

As a result of this transaction, the Telecom Italia Group effectively disposed of its ownership interest in the investment in Solpart Participações (although it remains the beneficiary) and the governance rights deriving thereof thus resolving the question concerning the overlapping of mobile and long-distance licenses held by the Tim Brasil group and Brasil Telecom group, to the benefit of all parties concerned, including the same Brasil Telecom and its shareholders.

Following the decision to dispose of the investments in Solpart Participações and Brasil Telecom Participações (both held by Telecom Italia International), and appointing JP Morgan as sales agent, the carrying amount of the two investments, as of September 30, 2006, were reclassified to discontinued operations/assets held for sale .

The value of the investment in ETECSA includes 64 million of residual goodwill, being the excess of the carrying amount over the corresponding share of net assets acquired.

The investment in Italtel Group S.p.A. in 2005 was recorded in investments in associates accounted for using the equity method because, although the Group owns a 19.37% stake (below 20% of the voting rights exercisable), Telecom Italia S.p.A. exercises



significant influence through the rights attributed to it by the shareholders' agreements.

On June 21, 2006, the Board of Directors of Italtel Group S.p.A. voted not to proceed with the project to list the shares of the company on the Italian stock exchange in the immediate future as resolved by the shareholders' meeting held on February 27, 2006.

The valuation using the equity method includes the share of profits (losses) for the year and the differences arising from the translation of foreign company financial statements. The 2006 consolidated statement of income was particularly impacted by ETECSA ( 47 million) and other companies ( 4 million) and in 2005 by Avea I.H.A.S. (- 122 million), ETECSA ( 45 million), Solpart Participações ( 94 million) and other companies (- 10 million).

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Aggregate 2006 and 2005 data relating to the major associates, prepared in accordance with IFRS, based on the Telecom Italia Group's share, is as follows:

|                                | As of December 31, |       |
|--------------------------------|--------------------|-------|
|                                | 2006               | 2005  |
|                                | (millions of Euro) |       |
| Total assets                   | 1,173              | 4,961 |
| Total liabilities              | 740                | 2,606 |
| Revenues                       | 498                | 2,278 |
| Net income (loss) for the year | 67                 | (114) |

**Investments in joint ventures** include the investments in Perseo S.r.l. and Sofora Telecomunicaciones S.A., in which 50% stakes are held.

The investment in Sofora Telecomunicaciones S.A. is accounted for using the equity method. From 2001 to 2004, following the monetary crisis in Argentina, the net equity of the company, which controls the Telecom Argentina group, was negative and the carrying amount, including the goodwill acquired, was written off. In 2005, the net equity of the Sofora group again became positive as a result of restructuring a part of the Telecom Argentina group's debt and, consequently, the carrying amount was proportionally adjusted for the Group's share of ownership (16 million). In 2006, the value of the investment was adjusted by 1 million bringing the investment value to 17 million at December 31, 2006. However, the impairment loss has not been reversed since all the conditions which led to the impairment of the investment in previous years have not been eliminated.

Aggregate 2006 and 2005 data, based on the Telecom Italia Group's share, is as follows:

|                     | As of December 31, |              |
|---------------------|--------------------|--------------|
|                     | 2006               | 2005         |
|                     | (millions of Euro) |              |
| Non-current assets  | 825                | 938          |
| Current assets      | 307                | 269          |
| <b>Total assets</b> | <b>1,132</b>       | <b>1,207</b> |

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|                                |                   |                   |
|--------------------------------|-------------------|-------------------|
| Non-current liabilities        | 500               | 767               |
| Current liabilities            | 477               | 299               |
|                                | <u>          </u> | <u>          </u> |
| <b>Total liabilities</b>       | <b>977</b>        | <b>1,066</b>      |
|                                | <u>          </u> | <u>          </u> |
| Revenues                       | 971               | 787               |
|                                | <u>          </u> | <u>          </u> |
| Operating income               | 113               | 65                |
|                                | <u>          </u> | <u>          </u> |
| Income before taxes            | 32                | 207               |
|                                | <u>          </u> | <u>          </u> |
| <b>Net income for the year</b> | <b>29</b>         | <b>54</b>         |
|                                | <u>          </u> | <u>          </u> |

The list of investments accounted for using the equity method is presented in Note 45 List of companies of the Telecom Italia Group .

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**Other investments** refer to the following:

|                                 | As of<br>December 31,<br>2004 | Discontinued<br>operations/<br>assets held<br>for sale | New<br>Investments | Disposals and<br>capital<br>reimbursements | Valuation<br>at fair<br>value | Reclassifications<br>and other<br>changes | As of<br>December 31,<br>2005 |
|---------------------------------|-------------------------------|--|--------------------|--|-------------------------------|---|-------------------------------|
| (millions of Euro)              |                               |  |                    |  |                               |   |                               |
| Brasil Telecom<br>Participações | 17                            |  |                    |  |                               | (17)                                      |                               |
| CMobil                          | 9                             |  |                    | (9)  |                               |   |                               |
| Consortium                      | 20                            |  |                    |  |                               |   | 20                            |
| Euskaltel                       | 13                            |  |                    | (13)                                       |                               |   |                               |
| Fin. Priv.                      | 15                            |  |                    |  |                               |   | 15                            |
| Forthnet                        | 10                            |  |                    | (10)                                       |                               |   |                               |
| MCC                             | 36                            |  |                    |  |                               |   | 36                            |
| Mediobanca                      | 168                           |  |                    |  | 59                            |   | 227                           |
| Neuf Telecom                    | 51                            |  |                    |  |                               |   | 51                            |
| Oger Telecom                    |                               |  | 178                |  |                               |   | 178                           |
| Sia                             | 11                            |  |                    |  |                               |   | 11                            |
| Solpart<br>Participações        | 95                            |  |                    |  |                               | (95)                                      |                               |
| Other                           | 34                            | (11)   | 4                  | (4)  |                               |   | 23                            |
| <b>Total</b>                    | <b>479</b>                    | <b>(11)</b>  | <b>182</b>         | <b>(36)</b>                                | <b>59</b>                     | <b>(112)</b>                              | <b>561</b>                    |

|                           | As of<br>December 31,<br>2005 | Discontinued<br>operations/<br>assets held<br>for sale | New<br>Investments | Disposals and<br>capital<br>reimbursements | Valuation<br>at fair<br>value | Reclassifications<br>and other<br>changes | As of<br>December 31,<br>2006 |
|---------------------------|-------------------------------|--|--------------------|--|-------------------------------|---|-------------------------------|
| (millions of Euro)        |                               |  |                    |  |                               |   |                               |
| Capitalia                 |                               |  |                    |  | 39                            | 36  | 75                            |
| Consortium                | 20                            |  |                    | (2)  |                               | (18)                                      |                               |
| Fin. Priv.                | 15                            |  |                    |  |                               |   | 15                            |
| Assicurazioni<br>Generali |                               |  |                    |  | 1                             | 4   | 5                             |
| MCC                       | 36                            |  |                    |  |                               | (36)                                      |                               |
| Mediobanca                | 227                           |  |                    |  | 26                            | 14  | 267                           |
| Neuf Telecom              | 51                            |  |                    | (51)                                       |                               |   |                               |
| New Satellite<br>Radio    |                               |  | 7                  |  |                               |   | 7                             |
| Oger Telecom              | 178                           |  | 197                |  |                               |   | 375                           |
| Sia                       | 11                            |  |                    |  |                               |   | 11                            |
| Other                     | 23                            |  | 1                  | (3)  |                               |   | 21                            |
| <b>Total</b>              | <b>561</b>                    |  | <b>205</b>         | <b>(56)</b>                                | <b>66</b>                     |   | <b>776</b>                    |

The increase of 215 million compared to December 31, 2005 is mainly due to the investment in Oger Telecom and the fair value adjustment to the investments in Capitalia and Mediobanca, partly offset by the sale of Neuf Télécom.

On May 26, 2006, the meeting of the parties to the Mediobanca shareholders' agreement approved the early dissolution of the investment company Consortium S.r.l. and assigned direct ownership of the Mediobanca and Assicurazioni Generali shares to the shareholders, in proportion to their respective stakes in the investment company. The transaction took place in over the counter market with settlement deferred and compensated through the distribution of profits and reserves by Consortium S.r.l. in July 2006. The net proceeds amount to 5 million.

After this transaction, Telecom Italia holds a 0.01% stake in Assicurazioni Generali and a 1.84% interest in Mediobanca.

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On May 11, 2006, the entire stake held in Neuf Télécom by Telecom Italia International (equal to about 4.99% of share capital) was sold to Louis Dreyfus and Société Française du Radiotéléphone for 199 million, realizing a gain of 148 million.

Effective January 1, 2006, MCC S.p.A. was non-proportionally partially spun-off to Capitalia S.p.A. by assigning a part of the equity of MCC S.p.A. to the beneficiary Capitalia S.p.A. with allocation of its shares, deriving from the reserved capital increase, to the minority shareholders of MCC S.p.A.. After this transaction, the shares of Capitalia S.p.A., since the company is listed, were measured at fair value and the fair value adjustment was recognized in a specific reserve under equity.

**Financial receivables and other non-current financial assets** decreased by 309 million compared to December 31, 2005. The composition is as follows:

|   | <b>As of December 31,</b> |             |
|---|---------------------------|-------------|
|   | <b>2006</b>               | <b>2005</b> |
|   | <b>(millions of Euro)</b> |             |
| Financial receivables for lessors net investments   | 229                       | 212         |
| Loans to employees  | 70                        | 79          |
| Hedging derivatives relating to hedged items classified as non-current assets/liabilities of a financial nature | 243                       | 276         |
| Other financial receivables   | 137                       | 421         |
| <b>Total</b>  | <b>679</b>                | <b>988</b>  |

Financial receivables for lessors net investments refer to:

Teleleasing lease contracts directly negotiated with customers and guaranteed by Telecom Italia S.p.A.;

medium/long-term portion of contracts which provide for the finance lease, of assets to customers which the Group has available under finance leaseback contracts, with the performance of accessory services under the full rent formula.

The total amount (non-current and current portions) of these receivables are as follows:

|  | <b>As of December 31,</b> |             |
|--|---------------------------|-------------|
|  | <b>2006</b>               | <b>2005</b> |

|                     | (millions of Euro) |            |
|---------------------|--------------------|------------|
| Non-current portion | 229                | 212        |
| Current portion     | 148                | 122        |
| <b>Total</b>        | <b>377</b>         | <b>334</b> |

Hedging derivatives relating to hedged items classified in non-current assets and liabilities of a financial nature refer to the accrued income component of the derivatives.

Additional information is provided in the Note 24 Financial instruments .

Other financial receivables decreased from 421 million at December 31, 2005 to 137 million mainly as a result of the reclassification of 309 million to cash from the escrow account at ABN Amro. This amount became available since the conditions for the contractual commitments with Opportunity did not occur. At December 31, 2006 such receivables include:

68 million relating to cash collateral with Goldman Sachs to guarantee the two Cross Currency Interest Rate Swap contracts;

22 million for the non-current portion of the remaining receivable due from PTT Srbija on the sale of Telekom Srbija;

24 million for loans made to Aree Urbane S.r.l..

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**Miscellaneous receivables and other non-current assets** increased from 825 million at December 31, 2005 to 871 million and include:

the fair value of the two call options on 50% of Sofora Telecomunicaciones share capital for 190 million ( 160 million at December 31, 2005);

the remaining receivable on the sale of 100% of Gruppo Buffetti for 6 million;

the tax credit from the advance payment of taxes on the provision for employee severance indemnities of 19 million ( 35 million at December 31, 2005);

medium/long-term prepaid expenses of 511 million ( 467 million at December 31, 2005) relating to the deferral of costs in conjunction with the recognition of revenues.

**NOTE 9 DEFERRED TAX ASSETS AND DEFERRED TAX LIABILITIES**

Net deferred tax assets decreased from 2,656 million at December 31, 2005 to 718 million and are presented in the balance sheet as follows:

|                          | <b>As of December 31,</b> |              |
|--------------------------|---------------------------|--------------|
|                          | <b>2006</b>               | <b>2005</b>  |
|                          | <b>(millions of Euro)</b> |              |
| Deferred tax assets      | 912                       | 2,793        |
| Deferred tax liabilities | (194)                     | (137)        |
| <b>Total</b>             | <b>718</b>                | <b>2,656</b> |

Deferred tax assets and liabilities are offset in the financial statements when the income taxes are levied by the same tax authority and where there is a legally enforceable right of offset. The gross amounts are as follows:

|  | <b>As of December 31,</b> |             |
|--|---------------------------|-------------|
|  | <b>2006</b>               | <b>2005</b> |
|  | <b>(millions of Euro)</b> |             |



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|                          |                   |                   |
|--------------------------|-------------------|-------------------|
| Deferred tax assets      | 1,714             | 3,118             |
| Deferred tax liabilities | (996)             | (462)             |
|                          | <u>          </u> | <u>          </u> |
| <b>Total</b>             | <b>718</b>        | <b>2,656</b>      |
|                          | <u>          </u> | <u>          </u> |

Changes in deferred tax assets and liabilities gave rise to a deferred tax charge for the year ended December 31, 2006 of 1,837 million (see Note 38 Income taxes for additional details on the tax charge). The tax effect on income and losses recognized directly in equity in 2006 is a charge of 83 million and mainly relates to the fair value adjustment of the hedging derivative instruments.

The other changes during the year in deferred taxes which did not have an effect on net income mainly related to the reduction in deferred tax liabilities recorded on the business combinations recognized according to IFRS 3 ( 5 million, of which 3 million relates to the purchase of Elefante TV-Delta TV and 2 million to the purchase of Liberty Surf Group S.A.).

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Temporary differences which make up this caption at December 31, 2006 and 2005 are the following:

|  | As of December 31, |              |
|--|--------------------|--------------|
|  | 2006               | 2005         |
|  | (millions of Euro) |              |
| <b>Deferred tax assets:</b>                                      |                    |              |
| • Write-downs of investments and other                           | 189                | 1,259        |
| • Unrealized intra-group gains                                   | 36                 | 31           |
| • Provisions for pension fund integration (Law No. 58/92)        | 194                | 227          |
| • Tax loss carryforwards   | 300                | 517          |
| • Provisions for risks and charges                               | 186                | 276          |
| • Provision for restoration and decommissioning costs            | 59                 | 55           |
| • Bad debts provisions   | 212                | 220          |
| • Recognition of revenues  | 124                | 177          |
| • Sale and lease back transactions on properties                 | 150                | 109          |
| • Derivative instruments   | 42                 | 130          |
| • Capital grants   | 46                 | 64           |
| • Other deferred tax assets                                      | 176                | 53           |
| <b>Total</b>   | <b>1,714</b>       | <b>3,118</b> |
| <b>Deferred tax liabilities:</b>                                 |                    |              |
| • Accelerated depreciation                                       | (601)              | (280)        |
| • Deferred gains   | (136)              | (108)        |
| • Discounting of provisions for employee severance indemnities   | (39)               | (28)         |
| • Notes and bonds  | (27)               | (34)         |
| • Other deferred tax liabilities                                 | (193)              | (12)         |
| <b>Total</b>   | <b>(996)</b>       | <b>(462)</b> |
| <b>Total deferred tax assets net of deferred tax liabilities</b> | <b>718</b>         | <b>2,656</b> |

The reduction in deferred tax assets gross of offsets compared to December 31, 2005 is principally due to the reversal of deferred tax assets on the writedown of investments in 2003, deducted for tax purposes over five years, and the reversal of deferred tax assets recognized on tax loss carryforwards by the Parent, Telecom Italia.

The increase in deferred tax liabilities gross of offsets compared to December 31, 2005 is mainly the result of the recognition in 2006 of deferred tax liabilities on accelerated depreciation taken by the Parent, Telecom Italia.

At December 31, 2006, the Group has unused tax loss carryforwards relating to the Parent, Telecom Italia, and some foreign companies (Telecom Italia Finance, Liberty Surf Group, Telecom Italia International and Tim Participações group) for 7,668 million, with the following expiration dates:

| <u>Year of expiration</u>           | <u>(millions of Euro)</u> |
|-------------------------------------|---------------------------|
| 2007                                | 78                        |
| 2008                                | 1,195                     |
| 2009                                | 32                        |
| 2010                                | 245                       |
| 2011                                | 24                        |
| Expiration beyond 2011              | 594                       |
| Without expiration                  | 5,500                     |
| <b>Total tax loss carryforwards</b> | <b>7,668</b>              |

Deferred tax assets relating to deductible temporary differences and unused tax loss carryforwards are recognized to the extent that it is probable that future profits will be available against which they can be utilized.

In particular, deferred tax assets have been calculated on tax loss carryforwards of 907 million at December 31, 2006 ( 1,567 million at December 31, 2005) and mainly relate to the Parent, Telecom Italia. Moreover, at

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December 31, 2006, deferred tax assets of 2,124 million have not been recognized on unused tax losses of 6,761 million since their recoverability is not considered probable ( 5,737 million at December 31, 2005).

At December 31, 2006, deferred taxes have not been recognized on tax-suspension reserves, subject to taxation in the event of distribution or utilization, in that their distribution or utilization is not foreseen.

Deferred taxes have not been recognized on the undistributed earnings of subsidiaries and associates in that the tax system of their parents provide for the participation exemption.

**NOTE 10 INVENTORIES**

Inventories decreased from 294 million at December 31, 2005 to 291 million. The composition of inventories is as follows:

|   | <b>As of December 31,</b> |             |
|---|---------------------------|-------------|
|   | <b>2006</b>               | <b>2005</b> |
|   | <b>(millions of Euro)</b> |             |
| Raw materials and supplies                  | 5                         | 8           |
| Work in progress and semi-finished products | 13                        | 24          |
| Finished goods                              | 273                       | 262         |
| <b>Total</b>                                | <b>291</b>                | <b>294</b>  |

Inventories are mainly held by Telecom Italia S.p.A. ( 125 million) and the companies in the Brazil Mobile Business Unit ( 58 million). They mainly consist of equipment, handsets and related fixed and mobile telecommunications accessories. Another 88 million relates to the Olivetti Business Unit for office products, specialized printers and gaming terminals.

Writedowns of inventories made in 2006 total 31 million ( 26 million in 2005) and mainly refer to the adjustment of equipment and fixed and mobile telephone handsets of Telecom Italia S.p.A. to estimated realizable value ( 22 million) and writedowns to the realizable value recorded by Olivetti S.p.A. ( 8 million).

No inventories are pledged as collateral.

**NOTE 11 TRADE AND MISCELLANEOUS RECEIVABLES AND OTHER CURRENT ASSETS**

**Trade and miscellaneous receivables and other current assets** decreased from 8,856 million at December 31, 2005 to 8,748 million and consist of the following:

|  | As of December 31, |              |
|--|--------------------|--------------|
|  | 2006               | 2005         |
|  | (millions of Euro) |              |
| <b>Receivables for construction contracts</b>        | <b>12</b>          | <b>37</b>    |
| Trade receivables:                                   |                    |              |
| • Receivables from customers                         | 5,731              | 5,960        |
| • Receivables from other telecommunication operators | 1,638              | 978          |
|  | <b>7,369</b>       | <b>6,938</b> |
| Miscellaneous receivables and other current assets:  |                    |              |
| • Other receivables                                  | 972                | 1,533        |
| • Trade and miscellaneous prepaid expenses           | 395                | 348          |
|  | <b>1,367</b>       | <b>1,881</b> |
| <b>Total</b>   | <b>8,748</b>       | <b>8,856</b> |

**Receivables for construction contracts** of 12 million mainly refer to Telecom Italia S.p.A. for network equipment, Lombardy Region health cards and works related to telephone installations customized for customers. They also include advances to suppliers of 2 million.

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**Trade receivables** amount to 7,369 million ( 6,938 million at December 31, 2005), and are net of the provision for bad debts of 791 million ( 773 million at December 31, 2005).

The increase in trade receivables from December 31, 2005 is principally the result of a different presentation of receivables due from other mobile operators which, partly as a result of the revision of the contracts that, following the integration of fixed-mobile operations, are no longer shown net of the corresponding liability.

The caption also includes 3 million ( 4 million at December 31, 2005) of medium/long-term trade receivables due from customers.

Trade receivables specifically refer to Telecom Italia S.p.A. ( 5,542 million) and the foreign mobile telephone companies ( 872 million).

Movements in the provision for bad debts are as follows:

|  | <u>2006</u>        | <u>2005</u> |
|--|--------------------|-------------|
|  | (millions of Euro) |             |
| <b>At January 1</b>                                | <b>773</b>         | <b>897</b>  |
| Discontinued operations/assets held for sale       |                    | (132)       |
| Charge to the statement of income                  | 252                | 264         |
| Utilization  | (212)              | (264)       |
| Release of the provision in excess of requirements | (17)               | (15)        |
| Exchange differences and other changes             | (5)                | 23          |
|  | <u>791</u>         | <u>773</u>  |
| <b>At December 31</b>                              | <b>791</b>         | <b>773</b>  |

**Other receivables** amount to 972 million ( 1,533 million at December 31, 2005) and are net of a provision of 52 million. Details are as follows:

|                            | <u>As of December 31,</u> |             |
|----------------------------|---------------------------|-------------|
|                            | <u>2006</u>               | <u>2005</u> |
|                            | (millions of Euro)        |             |
| Advances to suppliers      | 144                       | 60          |
| Receivables from employees | 33                        | 55          |
| Tax receivables            | 223                       | 230         |

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|  |            |              |
|--|------------|--------------|
| Receivables on the sales of consolidated investments | 4          | 28           |
| Sundry items   | 568        | 1,160        |
|  | <hr/>      | <hr/>        |
| <b>Total</b>   | <b>972</b> | <b>1,533</b> |
|  | <hr/>      | <hr/>        |

Advances to suppliers increased by 84 million mainly due to advances paid to the supplier Ericsson ( 61 million) on the contract for software updates for the GSM/EGPRS/UMTS networks for the Telecom Italia S.p.A. mobile network for the three years 2006-2008. These advances will be recovered when the invoices are issued for the release of the software.

Sundry items decreased by 592 million largely on account of the refund from the Tax Authorities, following the ruling handed down by the Regional Administrative Court (TAR) of Lazio on July 10, 2006, for the principal portion ( 546 million) of the TLC operating fee that Telecom Italia S.p.A. and ex-TIM S.p.A. had paid for the year 1999 pursuant to art. 20, Law No. 448/1998.

Sundry items include a receivable from the Tax Authorities ( 100 million) for the interest earned up to the date of the refund on the above principal portion of the TLC operating fee and receivables from factoring companies ( 146 million) following the assignment of receivables mostly due from the sales network.

**Trade and miscellaneous prepaid expenses** principally pertain to building leases, rentals and maintenance as well as the deferral of costs related to revenue recognition.

**NOTE 12 CURRENT INCOME TAX RECEIVABLES**

**Current income tax receivables** amount to 287 million ( 335 million at December 31, 2005) and mainly refer to IRES tax receivable on the consolidated national tax return filed by the Telecom Italia Group.

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**Securities** in current assets increased from 378 million at December 31, 2005 to 812 million. Details are as follows:

|  | <u>As of December 31,</u> |             |
|--|---------------------------|-------------|
|  | <u>2006</u>               | <u>2005</u> |
|  | (millions of Euro)        |             |
| Held-to-maturity financial assets:                             |                           |             |
| • Listed securities other than investments                     |                           | 3           |
| Available-for-sale financial assets:                           |                           |             |
| • Listed securities other than investments due beyond 3 months | 259                       | 374         |
| Financial assets at fair value through profit or loss:         |                           |             |
| • Listed securities, other than investments, held for trading  | 553                       | 1           |
| <b>Total</b>   | <b>812</b>                | <b>378</b>  |

The above securities (mainly bonds and shares held in SICAVs) refer to investments made by the Luxembourg subsidiary Telecom Italia Finance S.A. in the amount of 794 million.

Available-for-sale listed securities other than investments, due beyond 3 months refer to bonds issued by counterparties that have credit ratings of not less than A- assigned by Standard & Poor's or an equivalent level assigned by other agencies, and with different maturity dates but all are actively traded and, therefore, readily convertible into cash.

Listed securities other than investments held for trading refer to a very short-term investment in a monetary SICAV registered under Belgian law which was partially sold in February 2007 (542 million).

Additional information is provided in the Note 24 Financial instruments.

**NOTE 14 FINANCIAL RECEIVABLES AND OTHER CURRENT FINANCIAL ASSETS**

**Financial receivables and other current financial assets** decreased from 509 million at December 31, 2005 to 433 million. They consist of the following:



|   | As of December 31, |            |
|---|--------------------|------------|
|   | 2006               | 2005       |
|   | (millions of Euro) |            |
| Deposits for temporary investments of excess liquidity originally due beyond 3 months but less than 12 months | 17                 | 90         |
| Financial receivables for lessors net investments   | 148                | 122        |
| Other short-term financial receivables  | 52                 | 41         |
| Hedging derivatives relating to hedged items classified as current assets/liabilities of a financial nature   | 207                | 195        |
| Non hedging derivatives   | 9                  | 61         |
| <b>Total</b>  | <b>433</b>         | <b>509</b> |

**Deposits** refer entirely to the investment of excess liquidity made by Entel Bolivia.

**Financial receivables for lessors net investments** refer to:

- the current portion of Teleleasing lease contracts directly negotiated with customers and guaranteed by Telecom Italia S.p.A.;
- the current portion of contracts which provide for the finance lease of assets to customers which the Group has available under finance leaseback contracts with the performance of accessory services under the full rent formula.

**Other short-term financial receivables** include the current portion of loans receivable from personnel for 18 million and the receivable from PTT Srbija on the sale of Telekom Srbija for 13 million.

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**Hedging derivatives relating to hedged items classified as current assets/liabilities of a financial nature** refer to accrued income on derivatives.

Additional details are provided in the Note 24 Financial instruments .

**NOTE 15 CASH AND CASH EQUIVALENTS**

**Cash and cash equivalents** decreased from 10,323 million at December 31, 2005 to 7,219 million. They consist of the following:

|   | <b>As of<br/>December 31,</b> |               |
|---|-------------------------------|---------------|
|   | <b>2006</b>                   | <b>2005</b>   |
|   | <b>(millions of Euro)</b>     |               |
| Liquidity with banks, financial institutions and post offices | 7,186                         | 9,956         |
| Checks  | 4                             |               |
| Cash  | 1                             | 2             |
| Other receivables and deposits for cash flexibility           | 1                             | 34            |
| Securities other than investments (due within 3 months)       | 27                            | 331           |
| <b>Total</b>  | <b>7,219</b>                  | <b>10,323</b> |

The decrease in **liquidity with banks, financial institutions and post offices** from the end of 2005 is mainly due to the following:

- repayment of liabilities which became due during the course of 2006;
- early partial repayment of 3 billion of the Revolving Credit Facility maturing in 2012;
- payment of dividends.

The different technical forms used for the liquidity as of December 31, 2006 can be further analyzed as follows:

- maturities: 95% of deposits have a maximum maturity date of one month;

- counterparty risk: deposits are made with leading banks and financial institutions that have credit ratings of not less than A- assigned by Standard & Poor's or an equivalent level assigned by other agencies;
- country risk: the geographical location of deposits is principally on major European markets.

**Securities other than investments (due within 3 months)** include 20 million ( 327 million at December 31, 2005) of Euro Commercial Paper held by Telecom Italia Finance S.A. maturing within one month. The issuers all have credit ratings of not less than A- assigned by Standard & Poor's or an equivalent level assigned by other agencies, and are located in Europe.

**NOTE 16 DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE AND LIABILITIES RELATING TO DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE**

In the balance sheet at December 31, 2006, Discontinued operations/assets held for sale include the investments in Solpart Participações and Brasil Telecom Participações following the Group's decision to dispose of the investments.

In the statement of income and in the statement of cash flows for the year 2006, the respective captions, Net income (loss) from discontinued operations/assets held for sale and Cash flows generated by (used in) discontinued operations/assets held for sale include the relative effects of the divestitures of Gruppo Buffetti (sold in January 2006) and Digitel Venezuela (sold in May 2006). These captions include the results of Digitel Venezuela up to its divestiture (May 2006), the effects of the sale itself (a gain of 31 million net of transaction charges) and accruals to the provisions for risks and charges relating to the divestitures of Digitel Venezuela ( 9 million) and Tim Hellas ( 30 million).

In the balance sheet at December 31, 2005, Discontinued operations/assets held for sale and Liabilities relating to discontinued operations/assets held for sale include the balance sheet data of Gruppo Buffetti and Digitel Venezuela (sold in 2006).

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In the statement of income and in the statement of cash flows for the year 2005, the respective captions, Net income (loss) from discontinued operations/assets held for sale and Cash flows generated by (used in) discontinued operations/assets held for sale include the data of the Entel Chile group (sold in March 2005), the Finsiel group and Tim Hellas (sold in June 2005), Tim Perù (sold in August 2005), and Gruppo Buffetti (sold in January 2006) and Digitel Venezuela (sold in May 2006).

In the statement of income and cash flows for the year 2004 the respective captions Net income (loss) from discontinued operations/assets held for sale and Cash flows generated by (used in) discontinued operations/assets held for sale include the results of the Entel Chile group (sold in March 2005), the Finsiel group and Tim Hellas (sold in June 2005), Tim Perù (sold in August 2005), the Gruppo Buffetti (sold in January 2006) and Digitel Venezuela (sold in May 2006).

**Divestitures in 2006**

***Gruppo Buffetti***

On January 11, 2006, the sale of 100% of the capital of Gruppo Buffetti S.p.A. to Dylog Italia S.p.A. and Palladio Finanziaria S.p.A. was finalized, with a total positive financial effect of 66 million.

There was no effect on the statement of income in 2006 since the carrying amount had already been adjusted to the sale price at the end of 2005.

***Digitel Venezuela***

On May 25, 2006, the sale of 100% of the capital of Digitel by Tim International to Telvenco S.A. was finalized at a price of U.S.\$425 million (enterprise value). As a result, there was a reduction in net financial debt of approximately 318 million (including the deconsolidation of the net financial debt of the subsidiary sold).

In December 2006, under the contractual commitments guaranteed at the time of sale, Telvenco S.A. notified Tim International about a tax assessment issued by the local tax authorities on Digitel for approximately U.S.\$15 million.

Digitel filed an appeal against the assessment for approximately U.S.\$10 million, paying the difference of about U.S.\$5 million in January 2007.

Accordingly, an accrual was made to the provision for risks and charges on investments and corporate-related transactions for about 9 million to take into account not only the amount paid by Digital but also the interest payable from the date the payment was due up to the date of payment in addition to the relative penalties normally applied.

#### **Divestitures in 2005**

##### ***Entel Chile***

On March 29, 2005, Telecom Italia sold its 54.76% investment in the Chilean company Entel Chile S.A. to Almendral S.A. (an investment holding company listed on the stock exchange in Santiago, Chile which represents local businesses including the Hurtado Vicuña group and the Matte group).

The sale price was U.S.\$934 million ( 723 million) with a loss of 1 million in addition to 6 million of transaction charges.

##### ***Finsiel***

On April 26, 2005, Telecom Italia agreed the sale of its entire interest in Finsiel (79.5%) to the COS group. The sale was based on an enterprise value of 164 million. The sales terms are as follows:

- on June 28, 2005, a 59.6% interest was sold for a price of 87 million;
- on November 7, 2005, the remaining 19.9% was sold for a price of 28 million.

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The sale had no effect on the statement of income since the carrying amount had previously been adjusted to the sales price.

The residual receivable from the COS group of 26 million was collected in December 2006.

**Tim Hellas**

On June 15, 2005, Tim International N.V. sold the 80.87% investment in Tim Hellas Telecommunications S.A. to a vehicle owned by Apax Partners and Texas Pacific Group (TPG) for a price of 1,114 million corresponding to a total enterprise value of Tim Hellas of about 1,600 million or approximately 16.43 per share. The sale gave rise to a net gain of 410 million on consolidation.

During 2006, following progress on the legal disputes against Tim Hellas (whose potential negative outcome is partially guaranteed by Tim International), the provision for risks and charges on investments and corporate-related transactions was increased by 30 million bringing the total to 52 million.

\* \* \*

**Tim Perù**

On August 10, 2005, Tim International N.V. sold the entire investment in Tim Perù S.A.C. to Sercotel S.A. de C.V., a company controlled 100% by America Movil S.A. de C.V. at a price of 330 million. The sale gave rise to a net gain on consolidation in 2005 of 120 million (net of the relative transaction charges) and a decrease in net financial debt of more than 400 million.

The composition of **discontinued operations/assets held for sale** (and the related liabilities) is provided in the following table:

|   | <b>As of December 31,</b> |             |
|---|---------------------------|-------------|
|   | <b>2006</b>               | <b>2005</b> |
|   | <b>(millions of Euro)</b> |             |
| Discontinued operations/assets held for sale: |                           |             |
| • of a financial nature                       |                           | 37          |
| • of a non-financial nature                   | 235                       | 491         |

|   |            |            |
|---|------------|------------|
| <b>Total</b>  | <b>235</b> | <b>528</b> |
| <hr/>   |            |            |
| Liabilities relating to discontinued operations/assets held for sale: |            |            |
| • of a financial nature   |            | 143        |
| • of a non-financial nature   |            | 142        |
| <hr/>   |            |            |
| <b>Total</b>  |            | <b>285</b> |
| <hr/>   |            |            |

**Discontinued operations/assets held for sale of a financial nature** refer to:

|                   | <u>As of December 31,</u> |             |
|-------------------|---------------------------|-------------|
|                   | <u>2006</u>               | <u>2005</u> |
|                   | (millions of Euro)        |             |
| Gruppo Buffetti   |                           | 4           |
| Digitel Venezuela |                           | 33          |
| <hr/>             |                           |             |
|                   |                           | <b>37</b>   |
| <hr/>             |                           |             |

**Discontinued operations/assets held for sale of a non-financial nature** refer to:

|  | <u>As of December 31,</u> |             |
|--|---------------------------|-------------|
|  | <u>2006</u>               | <u>2005</u> |
|  | (millions of Euro)        |             |
| Investements in Solpart Participações and Brasil Telecom Participações | 235                       |             |
| Gruppo Buffetti  |                           | 113         |
| Digitel Venezuela  |                           | 378         |
| <hr/>  |                           |             |
|  | <b>235</b>                | <b>491</b>  |
| <hr/>  |                           |             |

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At December 31, 2005, this caption includes goodwill of 171 million, of which 12 million refers to Gruppo Buffetti (net of the writedown of 7 million to adjust the amount to the sale price) and 158 million to Digitel Venezuela.

**Liabilities relating to discontinued operations/assets held for sale of a financial nature** refer to:

|   | <u>As of December 31,</u> |             |
|---|---------------------------|-------------|
|   | <u>2006</u>               | <u>2005</u> |
|   | (millions of Euro)        |             |
| Gruppo Buffetti (current liabilities)       |                           | 19          |
| Digitel Venezuela (non-current liabilities) |                           | 124         |
|   |                           | <u>143</u>  |

**Liabilities relating to discontinued operations/assets held for sale of a non-financial nature** refer to:

|                   | <u>As of December 31,</u> |             |
|-------------------|---------------------------|-------------|
|                   | <u>2006</u>               | <u>2005</u> |
|                   | (millions of Euro)        |             |
| Gruppo Buffetti   |                           | 40          |
| Digitel Venezuela |                           | 102         |
|                   |                           | <u>142</u>  |

**The net income (loss)** from discontinued operations/assets held for sale in the statement of income is as follows:

|   | <u>Year ended December 31,</u> |             |             |
|---|--------------------------------|-------------|-------------|
|   | <u>2006</u>                    | <u>2005</u> | <u>2004</u> |
|   | (millions of Euro)             |             |             |
| <b>Results from discontinued operations/assets held for sale:</b> |                                |             |             |
| Revenues  | 121                            | 1,387       | 2,935       |
| Other income  |                                | 18          | 39          |



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|   |              |            |            |              |
|---|--------------|------------|------------|--------------|
| Operating expenses  |              | (89)       | (1,127)    | (2,324)      |
| Depreciation and amortization, impairment reversals (losses), gains (losses) on disposals |              | (17)       | (181)      | (404)        |
| <b>Operating income</b>   |              | <b>15</b>  | <b>97</b>  | <b>246</b>   |
| Net financial income (expenses)   |              |            | (22)       | (64)         |
| <b>Income before taxes from discontinued operations/assets held for sale</b>              |              | <b>15</b>  | <b>75</b>  | <b>182</b>   |
| Income taxes  |              |            | (31)       | (81)         |
| <b>Income after taxes from discontinued operations/assets held for sale</b>               | <b>(A)</b>   | <b>15</b>  | <b>44</b>  | <b>101</b>   |
| <b>Results of disposal:</b>   |              |            |            |              |
| Write-downs/provisions relating to assets held for sale                                   |              | (39)       | (9)        | (205)        |
| Net gain from discontinued operations   |              | 31         | 515        |              |
| Income taxes  |              |            |            | (14)         |
|   | <b>(B)</b>   | <b>(8)</b> | <b>506</b> | <b>(219)</b> |
| <b>Net income (loss) from discontinued operations/assets held for sale</b>                | <b>(A+B)</b> | <b>7</b>   | <b>550</b> | <b>(118)</b> |

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A breakdown of the **Income after taxes from discontinued operations/assets held for sale (A)** is as follows:

|                   | Year ended December 31, |           |            |
|-------------------|-------------------------|-----------|------------|
|                   | 2006                    | 2005      | 2004       |
|                   | (millions of Euro)      |           |            |
| Entel Chile group |                         | 26        | 49         |
| Finsiel group     |                         | (11)      | (7)        |
| Tim Hellas        |                         | 11        | 82         |
| Tim Perù          |                         | (3)       | (17)       |
| Gruppo Buffetti   |                         | 1         | 1          |
| Digitel Venezuela | 15                      | 20        | (7)        |
|                   | <b>15</b>               | <b>44</b> | <b>101</b> |

A breakdown of the **Results of disposal (B)** is as follows:

|                   | Year ended December 31, |            |              |
|-------------------|-------------------------|------------|--------------|
|                   | 2006                    | 2005       | 2004         |
|                   | (millions of Euro)      |            |              |
| Entel Chile group |                         | (7)        | (191)        |
| Finsiel group     |                         | (8)        | (28)         |
| Tim Hellas        | (30)                    | 410        |              |
| Tim Perù          |                         | 120        |              |
| Gruppo Buffetti   |                         | (9)        |              |
| Digitel Venezuela | 22                      |            |              |
|                   | <b>(8)</b>              | <b>506</b> | <b>(219)</b> |

**Net cash flows** from operating, investing and financing activities relating to discontinued operations/assets held for sale are as follows:

**Total cash flows generated by (used in) discontinued operations/assets held for sale**

Year ended December 31,

|   | 2006               | 2005      | 2004         |
|---|--------------------|-----------|--------------|
|   | (millions of Euro) |           |              |
| Cash flows from operating activities  | 33                 | 190       | 505          |
| Cash flows from investing activities  | (10)               | (124)     | (336)        |
| Cash flows from financing activities  | (36)               | (40)      | (278)        |
| <b>Total cash flows generated by (used in) discontinued operations/assets held for sale</b> | <b>(13)</b>        | <b>26</b> | <b>(109)</b> |

In particular:

**Cash flows from operating activities** are as follows:

|                                     | Year ended December 31, |            |            |
|-------------------------------------|-------------------------|------------|------------|
|                                     | 2006                    | 2005       | 2004       |
|                                     | (millions of Euro)      |            |            |
| Entel Chile group                   |                         | 61         | 289        |
| Finsiel group                       |                         | (12)       | (45)       |
| Tim Hellas                          |                         | 27         | 143        |
| Tim Perù                            |                         | 21         | 40         |
| Gruppo Buffetti                     |                         | 11         | 7          |
| Digitel Venezuela                   | 33                      | 69         | 58         |
| Other, adjustments and eliminations |                         | 13         | 13         |
|                                     | <b>33</b>               | <b>190</b> | <b>505</b> |

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**Cash flows from investing activities** are as follows:

|                                     | Year ended December 31, |              |              |
|-------------------------------------|-------------------------|--------------|--------------|
|                                     | 2006                    | 2005         | 2004         |
|                                     | (millions of Euro)      |              |              |
| Entel Chile group                   |                         | (12)         | (98)         |
| Finsiel group                       |                         | (3)          | (20)         |
| Tim Hellas                          |                         | (20)         | (141)        |
| Tim Perù                            |                         | (19)         | (24)         |
| Gruppo Buffetti                     |                         | (3)          | (1)          |
| Digitel Venezuela                   | (10)                    | (47)         | (21)         |
| Other, adjustments and eliminations |                         | (20)         | (31)         |
|                                     | <b>(10)</b>             | <b>(124)</b> | <b>(336)</b> |

**Cash flows from financing activities** are as follows:

|                                     | Year ended December 31, |             |              |
|-------------------------------------|-------------------------|-------------|--------------|
|                                     | 2006                    | 2005        | 2004         |
|                                     | (millions of Euro)      |             |              |
| Entel Chile group                   |                         | (2)         | (190)        |
| Finsiel group                       |                         | 15          | (21)         |
| Tim Hellas                          |                         | (17)        | (55)         |
| Tim Perù                            |                         | (8)         |              |
| Gruppo Buffetti                     |                         | (3)         |              |
| Digitel Venezuela                   | (36)                    | (32)        | (12)         |
| Other, adjustments and eliminations |                         | 7           |              |
|                                     | <b>(36)</b>             | <b>(40)</b> | <b>(278)</b> |

**NOTE 17 EQUITY**

**Equity** includes:

|   | <u>As of December 31,</u> |               |
|---|---------------------------|---------------|
|   | <u>2006</u>               | <u>2005</u>   |
|   | (millions of Euro)        |               |
| Equity attributable to equity holders of the Parent | 26,018                    | 25,662        |
| Equity attributable to Minority Interests           | 1,080                     | 1,323         |
| <b>Total</b>  | <b>27,098</b>             | <b>26,985</b> |

**Equity attributable to equity holders of the Parent** increased by 356 million compared to December 31, 2005 mainly due to:

- net income for the year ( 3,014 million);
- the increase from the conversion of bonds ( 22 million);
- the increase in Other income (loss) recognized directly in equity ( 227 million);
- the decrease in the Reserve for net translation differences (- 107 million);
- the distribution of dividends ( 2,766 million, net of dividends on shares held by Telecom Italia Finance).

**Equity attributable to Minority Interests** decreased by 243 million mainly due to the distribution of dividends ( 236 million) and the net loss for the year ( 11 million).

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The movements in **share capital** during 2004, 2005 and 2006 are presented in the following tables:

**Reconciliation between the number of outstanding shares at December 31, 2003 and December 31, 2004**

|   | Shares as of<br>December 31,<br>2003 | Shares issued as a<br>result of<br>bond conversions,<br>exercise of warrants<br>and stock option plans<br><br>(number of shares) | Shares as of<br>December 31,<br>2004 |
|---|--------------------------------------|--|--------------------------------------|
| Ordinary Shares                                       | 10,302,243,740                       | 19,757,329   | 10,322,001,069                       |
| Less: Treasury Shares                                 | (101,208,867)                        |  | (101,208,867)                        |
| <b>Outstanding Ordinary Shares</b>                    | <b>10,201,034,873</b>                | <b>19,757,329</b>  | <b>10,220,792,202</b>                |
| Outstanding Savings Shares                            | 5,795,921,069                        |  | 5,795,921,069                        |
| <b>Total shares issued by Telecom Italia S.p.A.</b>   | <b>16,098,164,809</b>                | <b>19,757,329</b>  | <b>16,117,922,138</b>                |
| Less: Treasury Shares                                 | (101,208,867)                        |  | (101,208,867)                        |
| <b>Telecom Italia S.p.A. total outstanding shares</b> | <b>15,996,955,942</b>                | <b>19,757,329</b>  | <b>16,016,713,271</b>                |

**Reconciliation between the number of outstanding shares at December 31, 2004 and December 31, 2005**

|   | Shares as of<br>December 31,<br>2004 | Shares issued as a<br>result of<br>bond conversions,<br>stock option plans<br>and merger of TIM<br>into Telecom Italia<br><br>(number of shares) | Shares as of<br>December 31,<br>2005 |
|---|--------------------------------------|--|--------------------------------------|
| Ordinary Shares                                     | 10,322,001,069                       | 3,048,481,087  | 13,370,482,156                       |
| Less: Treasury Shares                               | (101,208,867)                        | (24,607,520)   | (125,816,387)                        |
| <b>Outstanding Ordinary Shares</b>                  | <b>10,220,792,202</b>                | <b>3,023,873,567</b>   | <b>13,244,665,769</b>                |
| Outstanding Savings Shares                          | 5,795,921,069                        | 230,199,592  | 6,026,120,661                        |
| <b>Total shares issued by Telecom Italia S.p.A.</b> | <b>16,117,922,138</b>                | <b>3,278,680,679</b>   | <b>19,396,602,817</b>                |

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|   |                       |                      |                       |
|---|-----------------------|----------------------|-----------------------|
| Less: Treasury Shares                                 | (101,208,867)         | (24,607,520)         | (125,816,387)         |
| <b>Telecom Italia S.p.A. total outstanding shares</b> | <b>16,016,713,271</b> | <b>3,254,073,159</b> | <b>19,270,786,430</b> |

Reconciliation between the number of outstanding shares at December 31, 2005 and December 31, 2006

|   | Shares as of<br>December 31,<br>2005 | Shares issued as a<br>result of<br>bond conversions<br>(number of shares) | Shares as of<br>December 31,<br>2006 |
|---|--------------------------------------|---|--------------------------------------|
| Ordinary Shares                                       | 13,370,482,156                       | 10,240,922  | 13,380,723,078                       |
| Less: Treasury Shares                                 | (125,816,387)                        |   | (125,816,387)                        |
| Outstanding Ordinary Shares                           | 13,244,665,769                       | 10,240,922  | 13,254,906,691                       |
| Outstanding Savings Shares                            | 6,026,120,661                        |   | 6,026,120,661                        |
| <b>Total shares issued by Telecom Italia S.p.A.</b>   | <b>19,396,602,817</b>                | <b>10,240,922</b>   | <b>19,406,843,739</b>                |
| Less: Treasury Shares                                 | (125,816,387)                        |   | (125,816,387)                        |
| <b>Telecom Italia S.p.A. total outstanding shares</b> | <b>19,270,786,430</b>                | <b>10,240,922</b>   | <b>19,281,027,352</b>                |

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**Reconciliation between the value of the outstanding shares as of December 31, 2003 and December 31, 2004**

|  | Share capital as of<br>December 31, 2003 | Changes in share<br>capital as a result of<br>bond conversions,<br>exercise of warrants<br>and stock option plans | Share capital as of<br>December 31, 2004 |
|--|--|---|--|
|  |  | (millions of Euro)  |  |
| Ordinary Shares  | 5,666                                    | 11  | 5,677                                    |
| Less: Treasury Shares                                    | (56)                                     |   | (56)                                     |
| Outstanding Ordinary Shares                              | 5,610                                    | 11  | 5,621                                    |
| Outstanding Savings Shares                               | 3,188                                    |   | 3,188                                    |
| <b>Share capital issued by Telecom<br/>Italia S.p.A.</b> | <b>8,854</b>                             | <b>11</b>   | <b>8,865</b>                             |
| Less: Treasury Shares                                    | (56)                                     |   | (56)                                     |
| <b>Telecom Italia S.p.A. share capital</b>               | <b>8,798</b>                             | <b>11</b>   | <b>8,809</b>                             |

**Reconciliation between the value of the outstanding shares as of December 31, 2004 and December 31, 2005**

|  | Share capital as of<br>December 31, 2004 | Changes in share<br>capital as a result of<br>bond conversions,<br>stock option plans and<br>merger of TIM into<br>Telecom Italia | Share capital as of<br>December 31, 2005 |
|--|--|---|--|
|  |  | (millions of Euro)  |  |
| Ordinary Shares  | 5,677                                    | 1,677   | 7,354                                    |
| Less: Treasury Shares                                    | (56)                                     | (13)  | (69)                                     |
| Outstanding Ordinary Shares                              | 5,621                                    | 1,664   | 7,285                                    |
| Outstanding Savings Shares                               | 3,188                                    | 126   | 3,314                                    |
| <b>Share capital issued by Telecom Italia<br/>S.p.A.</b> | <b>8,865</b>                             | <b>1,803</b>  | <b>10,668</b>                            |
| Less: Treasury Shares                                    | (56)                                     | (13)  | (69)                                     |
| <b>Telecom Italia S.p.A. share capital</b>               | <b>8,809</b>                             | <b>1,790</b>  | <b>10,599</b>                            |



## Reconciliation between the value of the outstanding shares as of December 31, 2005 and December 31, 2006

|  | Share capital as of<br>December 31, 2005 | Changes in share<br>capital as a result of<br>bond conversions | Share capital as of<br>December 31, 2006 |
|--|--|--|--|
|  |  | (millions of Euro)   |  |
| Ordinary Shares  | 7,354                                    | 6  | 7,360                                    |
| Less: Treasury Shares                                    | (69)                                     |  | (69)                                     |
| Outstanding Ordinary Shares                              | 7,285                                    | 6  | 7,291                                    |
| Outstanding Savings Shares                               | 3,314                                    |  | 3,314                                    |
| <b>Share capital issued by Telecom Italia<br/>S.p.A.</b> | <b>10,668</b>                            | <b>6</b>   | <b>10,674</b>                            |
| Less: Treasury Shares                                    | (69)                                     |  | (69)                                     |
| <b>Telecom Italia S.p.A. share capital</b>               | <b>10,599</b>                            | <b>6</b>   | <b>10,605</b>                            |

The Company's share capital is divided into two classes of shares: Ordinary and Savings. **Ordinary shares** have the right to attend, take part and vote in the ordinary and extraordinary shareholders' meetings. The holders of such shares have the right to the earnings distributed by the Company after the distribution of dividends to the holders of savings shares. **Savings shares**, in the absence of voting rights in the ordinary and extraordinary shareholders' meetings of the Company, have the right to receive distribution of the net income for the year up to

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5% of the par value of the shares ( 0.55) and to receive a dividend premium of 2% of the par value of the Shares in excess of the dividend on ordinary shares.

**Reserve for additional paid-in capital** is equal to 1,689 million at December 31, 2006 and decreased by 4,776 million compared to December 31, 2005. The decrease is due to the balance of the following:

- the reclassification, for 4,796 million, to Other reserves and retained earnings (accumulated losses), including net income (loss) for the year , of the portion of the Reserve for additional paid-in capital deriving from the share capital increase to service the merger of TIM in Telecom Italia following the application of art. 7, paragraph 7 of Legislative Decree No. 38/2005;
- the additional paid-in capital, of 20 million, deriving from the issue of shares following the conversion of Telecom Italia 1.5% 2001 2010 convertible notes with a repayment premium .

**Reserve for net translation differences** shows a positive balance of 686 million at December 31, 2006, a decreased of 107 million compared to December 31, 2005. This relates mainly to translation differences on the financial statements of the Brazilian mobile telephone companies.

**Other reserves and retained earnings (accumulated losses), including net income (loss) for the year** amount to 13,038 million ( 7,805 million at December 31, 2005) and include:

- **Other income (loss) recognized directly in equity** of a positive 118 million at December 31, 2006 (a negative 109 million at December 31, 2005) referring to the following:
  - Reserve for fair value adjustments of hedging instruments for a negative 54 million at December 31, 2006 (a negative 216 million at December 31, 2005), attributable to the Parent for - 62 million and other Group companies for + 8 million. This reserve is expressed net of deferred tax assets of 15 million ( 95 million at December 31, 2005). This reserve includes the gains or losses related to the fair value adjustment on the effective portion of cash flow derivatives which hedge the exposure of cash flow fluctuations on assets or liabilities;
  - Reserve for fair value adjustments of available-for-sale financial assets is a positive 172 million (a positive 107 million at December 31, 2005). This reserve relates to the measurement at market price of Mediobanca shares ( 133 million), Capitalia shares ( 37 million) and Assicurazioni Generali shares ( 1 million) held by the Parent, in addition to other shares held by the Group ( 1 million) and is expressed net of deferred tax liabilities of 9 million.
- **Other reserves** are a positive 5,175 million at December 31, 2006 (a positive 3,835 million at December 31, 2005) and include the other reserves of the Parent net of the value of the treasury stock held by the Parent and Telecom Italia Finance for the amount in excess of the relative par value which was deducted from Share capital . Other reserves increased principally due to the aforementioned reclassification from Reserve for additional paid-in capital ( 1,022 million: 4,796 million net of 3,774 million reclassified to Retained earnings (accumulated losses), including net income (loss) for the year ), in addition to the appropriation of a part of the 2005 income ( 319 million).

- **Retained earnings (accumulated losses), including net income (loss) for the year**, at December 31, 2006, is 7,745 million, with an increase of 3,666 million compared to December 31, 2005 and is mainly due to:
  - net income for the year attributable to the equity holders of the Parent, equal to 3,014 million ( 3,216 million in 2005);
  - the amount (+ 3,774 million) deriving from the above reclassification of the Reserve for additional paid-in capital pursuant to the application of art. 7, paragraph 7, of Legislative Decree No. 38/2005;
  - the dividends declared and approved by shareholders of 2,766 million ( 1,912 million in 2005). Dividends payable to ordinary and savings shareholders are, respectively, 1,856 million ( 0.1400 per share) and 910 million ( 0.1510 per share).

**Equity attributable to Minority Interests**, equal to 1,080 million ( 1,323 million at December 31, 2005), includes the Net loss for the year attributable to Minority Interests of 11 million (net income of 474 million in

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2005) and decreased compared to December 31, 2005 principally due to the distribution of dividends ( 236 million). This item consists mainly of the equity attributable to the minority interests of the Brazil mobile telephony companies and the Media Business Unit.

The following table shows the future potential changes in share capital related to the convertible bonds and options in the stock option plans still outstanding at December 31, 2006:

|  | <b>Outstanding<br/>bonds /options<br/>rights at<br/>12/31/2006</b> | <b>Conversion/<br/>grant ratio</b> | <b>Number of<br/>maximum<br/>shares issuable</b> | <b>Par value<br/>(thousand<br/>of Euro)</b> | <b>Additional<br/>paid-in<br/>capital<br/>(thousand<br/>of Euro)</b> | <b>Subscription<br/>price per<br/>share<br/>(Euro)</b> |
|--|--|------------------------------------|--|---|--|--|
| <b>Additional increases approved (Ordinary Shares)</b>         |  |                                    |  |   |  |  |
| Telecom Italia 1.5% 2001 2010 notes                            | 484,990,163.00   | 0.471553                           | 228,698,566                                      | 125,784                                     | 359,206  |  |
| Stock Option Plan 2000   | 5,349,998.00   | 3.300871                           | 17,659,608                                       | 9,713                                       | 64,197   | 4.185259   |
| Stock Option Plan 2001   | 31,847,500.00  | 3.300871                           | 105,123,871                                      | 57,818                                      | 276,196  | 3.177343   |
| Stock Option Plan 2002 Top                                     | 9,480,001.33   | 3.300871                           | 31,292,243                                       | 17,211                                      | 70,034   | 2.788052   |
| Stock Option Plan 2002   | 16,471,053.93  | 3.300871                           | 54,368,456                                       | 29,902                                      | 128,141  |  |
| <i>Of which:</i>   |  |                                    |  |   |  |  |
| <i>Grants in March 2002</i>                                    | <i>15,801,053.50</i>   | <i>3.300871</i>                    | <i>52,156,879</i>                                | <i>28,686</i>                               | <i>124,030</i>   | <i>2.928015</i>  |
| <i>Grants in August 2002</i>                                   | <i>670,000.43</i>  | <i>3.300871</i>                    | <i>2,211,577</i>                                 | <i>1,216</i>                                | <i>4,111</i>   | <i>2.409061</i>  |
| Stock Option Plans 2000-2002 ex TIM                            | 9,795,656.00   | 1.73                               | 16,946,391                                       | 9,321                                       | 53,568   | 3.710983   |
| Stock Option Plans 2002-2003 ex TIM                            | 17,395,000.00  | 1.73                               | 30,093,350                                       | 16,551                                      | 82,065   | 3.277457   |
| Stock Option Plans 2003-2005 ex TIM                            | 1,685,900.00   | 1.73                               | 2,916,605  | 1,604                                       | 6,944  | 2.930636   |
| <b>Total additional increases approved (Ordinary Shares)</b>   |  |                                    | <b>487,099,090</b>                               | <b>267,904</b>                              | <b>1,040,351</b>   |  |
| <b>Additional increases not yet approved (Ordinary Shares)</b> |  |                                    | <b>1,600,000,000</b>                             | <b>880,000</b>                              |  |  |

With regard to the Telecom Italia 1.5% 2001 2010 convertible notes with a repayment premium , it should be noted that the number of outstanding notes at December 31, 2006 includes 3,500 notes for which the conversion to shares had already been requested. On January 15, 2007, the corresponding No. 1,649 Ordinary Shares were issued for a total par value of 0.9 thousand and additional paid-in capital of 2.6 thousand.

Additional details on the stock option plans are disclosed in Note 42 Stock option plans of the Telecom Italia Group .

The May 6, 2004 Shareholders Meeting also granted the Board of Directors the right (which, to date, has not been exercised), for a maximum period of five years beginning May 6, 2004, to increase against payment, at one or more times, the share capital for a maximum total amount of 880,000,000, through the issue of a maximum of 1,600,000,000 Ordinary Shares, in whole or in part:

- (i) to be offered as pre-emptive rights to the shareholders and convertible noteholders, or
- (ii) to be offered for subscription to the employees of Telecom Italia S.p.A. or to the companies which it controls, with the exclusion of the pre-emptive rights, pursuant to the combined provision of art. 2441, last paragraph, of the Italian Civil Code, and art. 134, second paragraph, of Legislative Decree No. 58/1998.

The resolutions to be adopted by the Board of Directors for capital increases in exercising the aforementioned right shall establish the subscription price (including any additional paid-in-capital) and shall fix a specific deadline

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for the subscription of the shares; they may also provide that, in the event the increase voted by the Board is not fully subscribed by the deadline set each time for that purpose, the capital shall be increased for an amount equal to the subscriptions received up to that deadline date.

The Board of Directors at its Meeting held on March 8, 2007 adopted a resolution authorizing that the net income for the year 2006 resulting from the separate financial statements of the Parent, Telecom Italia S.p.A., equal to 4,144 million, will be appropriated as dividends for 2,851 million for distribution to the shareholders:

- 0.1400 for each Ordinary Share;
- 0.1510 for each Savings Share;

gross of withholdings as established by law. Undistributed net income will be appropriated to retained earnings.

**NOTE 18 FINANCIAL LIABILITIES (CURRENT AND NON-CURRENT)**

Non-current financial liabilities decreased from 42,146 million at December 31, 2005 to 40,803 million at December 31, 2006 and current financial liabilities decreased from 9,812 million at December 31, 2005 to 5,653 million at December 31, 2006.

The composition is as follows:

|   | <b>As of December 31,</b> |               |
|---|---------------------------|---------------|
|   | <b>2006</b>               | <b>2005</b>   |
|   | <b>(millions of Euro)</b> |               |
| <b>Financial payables (medium/long-term):</b>   |                           |               |
| • Notes and bonds   | 29,856                    | 29,281        |
| • Convertible and exchangeable notes/bonds  | 482                       | 476           |
|   | <b>30,338</b>             | <b>29,757</b> |
| • Amounts due to banks  | 6,832                     | 9,462         |
| • Hedging derivatives relating to hedged items classified as non-current assets/liabilities of a financial nature | 1,451                     | 730           |
| • Other financial payables  | 221                       | 303           |

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|   |                   |                   |
|---|-------------------|-------------------|
|   | 38,842            | 40,252            |
| • Finance lease liabilities (medium/long-term)  | 1,847             | 1,894             |
| • Other financial liabilities (medium/long-term)  | 114               |                   |
|   | <u>          </u> | <u>          </u> |
| <b>Total non current financial liabilities (A)</b>  | <b>40,803</b>     | <b>42,146</b>     |
|   | <u>          </u> | <u>          </u> |
| <b>Financial payables (short-term):</b>   |                   |                   |
| • Notes and bonds   | 4,050             | 6,181             |
| • Convertible and exchangeable notes/bonds  | 7                 | 2,043             |
|   | <u>          </u> | <u>          </u> |
|   | 4,057             | 8,224             |
| • Amounts due to banks  | 906               | 646               |
| • Hedging derivatives relating to hedged items classified as current assets/liabilities of a financial nature | 219               | 185               |
| • Non-hedging derivatives   | 12                | 64                |
| • Other financial payables  | 180               | 453               |
|   | <u>          </u> | <u>          </u> |
|   | 5,374             | 9,572             |
| • Finance lease liabilities   | 269               | 234               |
| • Other financial liabilities   | 10                | 6                 |
|   | <u>          </u> | <u>          </u> |
| <b>Total current financial liabilities (B)</b>  | <b>5,653</b>      | <b>9,812</b>      |
|   | <u>          </u> | <u>          </u> |
| <b>Total financial liabilities (C)= (A)+(B)</b>   | <b>46,456</b>     | <b>51,958</b>     |
|   | <u>          </u> | <u>          </u> |
| <b>Liabilities related to discontinued operations/assets held for sale (D)</b>                                |                   | <b>143</b>        |
|   | <u>          </u> | <u>          </u> |
| <b>Total gross financial debt (E)= (C)+(D)</b>  | <b>46,456</b>     | <b>52,101</b>     |
|   | <u>          </u> | <u>          </u> |

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**Notes and bonds** total 33,906 million ( 35,462 million at December 31, 2005) and decreased by 1,556 million. Details are as follows:

|   | <b>As of December 31,</b> |               |
|---|---------------------------|---------------|
|   | <b>2006</b>               | <b>2005</b>   |
|   | <b>(millions of Euro)</b> |               |
| Non-current portion                                     | 29,856                    | 29,281        |
| Current portion   | 4,050                     | 6,181         |
| <b>Total carrying amounts</b>                           | <b>33,906</b>             | <b>35,462</b> |
| Fair value adjustment and measurement at amortized cost | (787)                     | (885)         |
| <b>Total nominal repayment amount</b>                   | <b>33,119</b>             | <b>34,577</b> |

The nominal repayment amount totals 33,119 million and decreased by 1,458 million compared to December 31, 2005 ( 34,577 million), mainly due to repayments made by Telecom Italia S.p.A. and Telecom Italia Finance S.A. during 2006 and strengthening of the euro against the U.S.\$.

The regulations and/or Offering Circulars relating to the bonds described below are available on the corporate website <http://www.telecomitalia.it>.

Bonds expressed at the nominal amount of principal refer to the following:

**Notes and bonds issued by Telecom Italia S.p.A. (for a total of 10,936 million):**

- notes in the aggregate principal amount of 2,500 million, issued on February 1, 2002, divided into two tranches of 1,250 million each, at annual fixed rates, respectively, with a coupon of 5.625%, maturing February 1, 2007 (the tranche was duly repaid at maturity) and with a coupon of 6.25%, maturing February 1, 2012;
- bonds 2002-2022 reserved in the aggregate principal amount of subscription by employees, in service or retired, of companies, directly and indirectly, controlled by Telecom Italia S.p.A., with headquarters in Italy, for 250 million;
- bonds in the aggregate principal amount of 3,000 million, issued on January 29, 2004, divided into three tranches: the first, for 1,000 million, with a quarterly coupon indexed to the 3-month Euribor + 0.33%, maturing October 29, 2007 was repaid before maturity on January 30, 2006); the second, for 750 million, with an annual fixed-rate coupon of 4.50%,



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maturing January 28, 2011; the third, for 1,250 million, with an annual fixed-rate coupon of 5.375%, maturing January 29, 2019;

- notes in the aggregate principal amount of 110 million issued on April 8, 2004 with a quarterly coupon equal to the 3-month Euribor + 0.60%, maturing March 30, 2009;
- bonds in the aggregate principal amount of GBP 850 million (equivalent to 1,266 million at December 31, 2006) issued on June 24, 2004, with an annual fixed-rate coupon of 6.375%, maturing June 24, 2019;
- bonds in the aggregate principal amount of 120 million issued on November 23, 2004 with a quarterly coupon equal to the 3-month Euribor + 0.66%, maturing November 23, 2015;
- bonds in the aggregate principal amount of 850 million issued on March 17, 2005 with an annual fixed-rate coupon of 5.25%, maturing March 17, 2055;
- bonds in the aggregate principal amount of GBP 500 million (equivalent to 744 million at December 31, 2006) issued on June 29, 2005, with an annual fixed-rate coupon of 5.625%, maturing December 29, 2015;
- notes in the aggregate principal amount of 1,000 million issued on December 6, 2005 with a quarterly coupon equal to the 3-month Euribor + 0.53%, maturing December 6, 2012;
- notes in the aggregate principal amount of 750 million issued on May 19, 2006 with an annual fixed-rate coupon of 4.75%, maturing May 19, 2014;
- bonds in the aggregate principal amount of GBP 400 million (equivalent to 596 million at December 31, 2006) issued on May 19, 2006 with an annual fixed-rate coupon of 5.875%, maturing May 19, 2023;

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- notes in the aggregate principal amount of 750 million issued on June 9, 2006 with a quarterly coupon equal to the 3-month Euribor + 0.22%, maturing June 9, 2008.

**Notes and bonds issued by Telecom Italia Finance S.A. (a wholly-owned subsidiary of Telecom Italia S.p.A.) and guaranteed by Telecom Italia S.p.A. (for a total of 12,616 million):**

- notes issued April 20, 2001 on international markets in the aggregate principal amount of a total of 6,000 million. The issue is divided into three tranches: the first two tranches were duly repaid; the third tranche is for 2,000 million with an annual fixed-rate of 7.25%, maturing April 20, 2011;
- notes 1999-2009 in the aggregate principal amount of 1,500 million with an annual fixed-rate coupon of 5.15%, maturing in February 9, 2009.

All of the notes and bonds listed below were originally issued by Olivetti Finance N.V.S.A. (merged into Telecom Italia Finance S.A. effective June 1, 2004) and are guaranteed by Telecom Italia S.p.A.:

- notes denominated Telecom Italia Finance S.A. 499,669,000 Guaranteed Floating Rate Extendable Notes Due 2008 maturing September 14, 2008, with a quarterly coupon indexed to the 3-month Euribor + 130 basis points. In accordance with the terms and conditions of the notes, noteholders in possession of notes totaling 48,000 chose not to extend the maturity term of the notes on December 14, 2006 (original maturity date of the notes) and the company proceeded to repay the notes for that amount;
- notes 2002-2007 in the aggregate principal amount of 1,720 million with an annual fixed-rate coupon of 6.5%, maturing April 24, 2007;
- notes 2003-2008 in the aggregate principal amount of 1,659 million with an annual fixed-rate coupon of 5.875%, maturing January 24, 2008;
- notes 1999-2009 in the aggregate principal amount of 2,210 million with an annual fixed-rate coupon of 6.575%, maturing July 30, 2009;
- notes 2002-2012 in the aggregate principal amount of 1,000 million with an annual fixed-rate coupon of 7.25%, maturing April 24, 2012;
- notes 2003-2013 in the aggregate principal amount of 850 million with an annual fixed-rate coupon of 6.875%, maturing January 24, 2013;
- bonds 2002-2032 in the aggregate principal amount of JPY 20 billion (equivalent to 127 million at December 31, 2006) with a semi-annual fixed-rate coupon of 3.55%, maturing May 14, 2032 (callable by the issuer annually beginning from May 14, 2012);

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- bonds 2003-2033 in the aggregate principal amount of 1,050 million with an annual fixed-rate coupon of 7.75%, maturing January 24, 2033.

**Notes and bonds issued by Telecom Italia Capital S.A. (a wholly-owned subsidiary of Telecom Italia S.p.A.) and guaranteed by Telecom Italia S.p.A. (in the aggregate principal amount of 9,567 million):**

- issue of multi-tranche fixed-rate bonds on October 29, 2003, in the aggregate principal amount of U.S.\$ 4,000 million. The issue is divided into three tranches as follows:

U.S.\$1,000 million (equivalent to 759 million at December 31, 2006), with an annual fixed-rate coupon of 4%, maturing November 15, 2008;

U.S.\$2,000 million (equivalent to 1,519 million at December 31, 2006), with an annual fixed-rate coupon of 5.25%, maturing November 15, 2013;

U.S.\$1,000 million (equivalent to 759 million at December 31, 2006), with an annual fixed-rate coupon of 6.375%, maturing November 15, 2033;

- issue of multi-tranche fixed-rate bonds on October 6, 2004, in the aggregate principal amount of U.S.\$ 3,500 million. The issue is divided into three tranches as follows:

U.S.\$1,250 million (equivalent to 949 million at December 31, 2006) with an annual fixed-rate coupon of 4%, maturing January 15, 2010;

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U.S.\$1,250 million (equivalent to 949 million at December 31, 2006) with an annual fixed-rate coupon of 4.95%, maturing September 30, 2014;

U.S.\$1,000 million (equivalent to 759 million at December 31, 2006) with an annual fixed-rate coupon of 6%, maturing September 30, 2034;

- issue of multi-tranche bonds on September 28, 2005 in the aggregate principal amount of U.S.\$2,500 million. The issue is divided into three tranches as follows:

U.S.\$400 million (equivalent to 304 million at December 31, 2006) with a quarterly coupon indexed to the 3-month U.S.\$ Libor + 0.48%, maturing February 1, 2011;

U.S.\$700 million (equivalent to 532 million at December 31, 2006) with 4.875% annual fixed-rate interest with a semi-annual coupon, maturing October 1, 2010;

U.S.\$1,400 million (equivalent to 1,063 million at December 31, 2006) with 5.25% annual fixed-rate interest with a semi-annual coupon, maturing October 1, 2015;

- issue of multi-tranche bonds on July 18, 2006 in the aggregate principal amount of U.S.\$2,600 million. The issue is divided into three tranches as follows:

U.S.\$850 million (equivalent to 645 million at December 31, 2006), with a coupon indexed to the 3-month U.S.\$ Libor + 0.61%, maturing July 18, 2011;

U.S.\$750 million (equivalent to 570 million at December 31, 2006), with 6.20% annual fixed-rate interest with a semi-annual coupon, maturing July 18, 2011;

U.S.\$1,000 million (equivalent to 759 million at December 31, 2006), with 7.20% annual fixed-rate interest with a semi-annual coupon, maturing July 18, 2036.

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The following table lists the notes and bonds issued to third parties by companies in the Telecom Italia Group, divided by issuing company, expressed at the nominal repayment amount and market value.

| Original Currency  | Amount in original currency (million) | Nominal repayment amount in Euro (million) | Coupon                     | Issue date | Maturity date | Issue price (%) | Market price as of December 31, 2006 (%) | Market value as of December 31, 2006 (millions of Euro) |               |
|--|---------------------------------------|--|----------------------------|------------|---------------|-----------------|--|---|---------------|
| <b>Notes and bonds issued by Telecom Italia S.p.A.</b>   |                                       |  |                            |            |               |                 |  |   |               |
| Euro   | 1,250                                 | 1,250                                      |                            | 5.625%     | 02/01/2002    | 02/01/2007      | 99.841                                   | 100.126   | 1,252         |
| Euro   | 750                                   | 750  | 3 month Euribor            | +0.22%     | 06/09/2006    | 06/09/2008      | 100                                      | 100.00  | 750           |
| Euro   | 110                                   | 110  | 3 month Euribor            | +0.60%     | 04/08/2004    | 03/30/2009      | 100                                      | 100.797   | 111           |
| Euro   | 750                                   | 750  |                            | 4.500%     | 01/29/2004    | 01/28/2011      | 99.56                                    | 99.39   | 745           |
| Euro   | 1,250                                 | 1,250                                      |                            | 6.250%     | 02/01/2002    | 02/01/2012      | 98.952                                   | 106.038   | 1,325         |
| Euro   | 1,000                                 | 1,000                                      | 3 month Euribor            | +0.53%     | 12/06/2005    | 12/06/2012      | 100                                      | 99.27   | 993           |
| Euro   | 750                                   | 750  |                            | 4.750%     | 05/19/2006    | 05/19/2014      | 99.156                                   | 98.00   | 735           |
| Euro   | 120                                   | 120  | 3 month Euribor            | +0.66%     | 11/23/2004    | 11/23/2015      | 100                                      | 97.694  | 117           |
| GBP  | 500                                   | 744  |                            | 5.625%     | 06/29/2005    | 12/29/2015      | 99.878                                   | 95.12   | 708           |
| Euro   | 1,250                                 | 1,250                                      |                            | 5.375%     | 01/29/2004    | 01/29/2019      | 99.07                                    | 98.43   | 1,230         |
| GBP  | 850                                   | 1,266                                      |                            | 6.375%     | 06/24/2004    | 06/24/2019      | 98.85                                    | 100.076   | 1,267         |
| Euro   | 250                                   | 250  | 6 month Euribor (base 365) |            | 01/01/2002    | 01/01/2022      | 100                                      | 100   | 250           |
| GBP  | 400                                   | 596  |                            | 5.875%     | 05/19/2006    | 05/19/2023      | 99.622                                   | 95.714  | 570           |
| Euro   | 850                                   | 850  |                            | 5.250%     | 03/17/2005    | 03/17/2055      | 99.667                                   | 84.55   | 719           |
| <b>Sub-Total</b>   |                                       | <b>10,936</b>                              |                            |            |               |                 |  |   | <b>10,772</b> |
| <b>Notes and bonds issued by Telecom Italia Finance S.A. and guaranteed by Telecom Italia S.p.A.</b> |                                       |  |                            |            |               |                 |  |   |               |
| Euro   | 1,720                                 | 1,720                                      |                            | 6.500%     | 04/24/2002    | 04/24/2007      | 100.911(*)                               | 100.697   | 1,732         |
| Euro   | 1,659                                 | 1,659                                      |                            | 5.875%     | 01/24/2003    | 01/24/2008      | 99.937                                   | 101.607   | 1,686         |
| Euro   | 499.67                                | 500  | 3 month Euribor            | +1.3%      | 09/14/2006    | 09/14/2008      | 100                                      | 103.259   | 516           |
| Euro   | 1,500                                 | 1,500                                      |                            | 5.150%(b)  | 02/09/1999    | 02/09/2009      | 99.633                                   | 101.501   | 1,523         |
| Euro   | 2,210                                 | 2,210                                      |                            | 6.575%(c)  | 07/30/1999    | 07/30/2009      | 98.649(*)                                | 105.114   | 2,323         |
| Euro   | 2,000                                 | 2,000                                      |                            | 7.250%(a)  | 04/20/2001    | 04/20/2011      | 99.214                                   | 110.221   | 2,204         |
| Euro   | 1,000                                 | 1,000                                      |                            | 7.250%     | 04/24/2002    | 04/24/2012      | 101.651(*)                               | 110.782   | 1,108         |
| Euro   | 850                                   | 850  |                            | 6.875%     | 01/24/2003    | 01/24/2013      | 99.332                                   | 109.599   | 932           |
| JPY  | 20,000                                | 127  |                            | 3.550%     | 04/22/2002    | 05/14/2032      | 99.25                                    | 122.728   | 156           |
| Euro   | 1,050                                 | 1,050                                      |                            | 7.750%     | 01/24/2003    | 01/24/2033      | 109.646(*)                               | 118.86  | 1,248         |
| <b>Sub-Total</b>   |                                       | <b>12,616</b>                              |                            |            |               |                 |  |   | <b>13,428</b> |
| <b>Notes and bonds issued by Telecom Italia Capital S.A. and guaranteed by Telecom Italia S.p.A.</b> |                                       |  |                            |            |               |                 |  |   |               |
| USD  | 1,000                                 | 759  |                            | 4.000%     | 10/29/2003    | 11/15/2008      | 99.953                                   | 97.326  | 739           |
| USD  | 1,250                                 | 949  |                            | 4.000%     | 10/06/2004    | 01/15/2010      | 99.732                                   | 95.498  | 906           |
| USD  | 700                                   | 532  |                            | 4.875%     | 09/28/2005    | 10/01/2010      | 99.898                                   | 97.202  | 517           |
| USD  | 400                                   | 304  | 3 month U.S.\$ Libor       | +0.48%     | 09/28/2005    | 02/01/2011      | 100                                      | 99.476  | 302           |
| USD  | 850                                   | 645  | 3 month U.S.\$ Libor       | +0.61%     | 07/18/2006    | 07/18/2011      | 100                                      | 99.867  | 644           |
| USD  | 750                                   | 570  |                            | 6.200%     | 07/18/2006    | 07/18/2011      | 99.826                                   | 101.448   | 578           |
| USD  | 2,000                                 | 1,519                                      |                            | 5.250%     | 10/29/2003    | 11/15/2013      | 99.742                                   | 95.418  | 1,449         |
| USD  | 1,250                                 | 949  |                            | 4.950%     | 10/06/2004    | 09/30/2014      | 99.651                                   | 92.60   | 879           |
| USD  | 1,400                                 | 1,063                                      |                            | 5.250%     | 09/28/2005    | 10/01/2015      | 99.370                                   | 93.173  | 990           |
| USD  | 1,000                                 | 759  |                            | 6.375%     | 10/29/2003    | 11/15/2033      | 99.558                                   | 94.43   | 717           |
| USD  | 1,000                                 | 759  |                            | 6.000%     | 10/06/2004    | 09/30/2034      | 99.081                                   | 90.759  | 689           |
| USD  | 1,000                                 | 759  |                            | 7.200%     | 07/18/2006    | 07/18/2036      | 99.440                                   | 104.022   | 790           |

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|                  |               |               |
|------------------|---------------|---------------|
| <b>Sub-Total</b> | <b>9,567</b>  | <b>9,200</b>  |
| <b>Total</b>     | <b>33,119</b> | <b>33,400</b> |

Notes (a), (b), (c): see the following paragraph Mechanism describing how coupons change on step-up/step-down notes and bonds in relation to a change in the rating .

(\*) Weighted average issue price for notes and bonds issued with more than one tranche.

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The mechanism for coupon changes on step-up/step-down notes and bonds is described below and on the corporate website ([www.telecomitalia.it](http://www.telecomitalia.it)) under Investors .

Ratings of Telecom Italia by the major rating agencies at December 31, 2006 are as follows:

| <b>S&amp;P s</b> |                | <b>Moody s</b> |                | <b>Fitch Ratings</b> |                |
|------------------|----------------|----------------|----------------|----------------------|----------------|
| <b>Rating</b>    | <b>Outlook</b> | <b>Rating</b>  | <b>Outlook</b> | <b>Rating</b>        | <b>Outlook</b> |
| BBB+             | Negative       | Baa2           | Stable         | BBB+                 | Stable         |

**(a) Telecom Italia Finance S.A. Euro Notes : 2,000 million, 7.25% interest, maturing April 2011**

These securities carry protection for investors which would be triggered by a change in the rating assigned to Telecom Italia to below the Baa1/BBB+ ratings (by Moody s and S&P s, respectively): each downgrade in the rating by one notch by each of the two rating agencies to below the stated thresholds would cause an increase in the coupon rate of 0.25%, starting from the coupon payment date subsequent to the downgrade in the rating.

The downgrade in the rating from the thresholds is evaluated at the end of each coupon period and, on the basis of this evaluation, the interest for the next coupon is fixed; therefore, changes in the ratings during the coupon interest period would have no impact on the coupon payable during that period.

Nevertheless, the relative step-up/step-down will only be applied when the rating at the end of the coupon period is different from the rating at the end of the preceding coupon period.

By virtue of this mechanism, the coupons for these securities are currently subject to an increase of 0.25% due to a Baa2 rating assigned by Moody s in August 2003. The increase was applied beginning from the coupon period which started in April 2004, accordingly, the coupon is equal to 7.25% for securities maturing in April 2011.

**(b) Telecom Italia Finance S.A. Notes: 1,500 million, 5.15% interest, maturing February 2009**

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These notes carry protection for investors which would only be triggered by a downgrade in the minimum rating (among the ratings assigned by the various agencies, in this specific case, the Baa2 rating by Moody's).

At the beginning of every coupon period, this minimum rating will be checked, and depending upon the rating, the coupon interest will be fixed; once fixed, changes in the minimum rating during the coupon period will have no effect on the coupon to be paid, and will only have an impact when the next coupon interest rate is fixed (if the changes are still in effect).

Starting from the initial level of the coupon at issue (5%), a 0.15% increase in interest was granted to investors to remain in place until to the maturity date, bringing the current coupon interest rate to 5.15%.

This current coupon can be further increased in relation to the level of the minimum rating:

- if, at the time the coupon interest is fixed, the minimum rating is Ba1/BB+ or below, the current coupon will be increased by 1.5%;
- if, at the time the coupon interest is fixed, the minimum rating is Baa3/BBB-, the current coupon will be increased by 0.5%;
- ratings higher than the minimum rating do not lead to increases in the current coupon.

Therefore, only future downgrades in the minimum rating could cause an increase in the current coupon; this coupon cannot be reduced because of upgrades in the rating.

### **(c) Telecom Italia Finance S.A. Notes: 2,210 million, 6.575% interest, maturing July 2009**

These notes carry protection for investors which would be triggered by a change in the minimum rating (among those assigned by the various agencies, in this specific case, the Baa2 rating by Moody's).



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At the beginning of every coupon period, this minimum rating will be checked and depending upon the rating, the coupon interest will be fixed; once fixed, changes in the minimum rating during the coupon period will have no effect on the coupon to be paid, and will only have an impact when the next coupon interest rate is fixed (if the changes are still in effect).

Starting from the initial level of interest at issue (6.125%), the coupon to be paid will be increased in relation to the level of the minimum rating:

- if, at the time the coupon is fixed, the minimum rating is Ba1/BB+ or below, the original coupon will be increased by 1.95%;
- if, at the time the coupon interest is fixed, the minimum rating is Baa3/BBB-, the original coupon will be increased by 0.95%;
- if, at the time the coupon interest is fixed, the minimum rating is Baa2/BBB, the original coupon will be increased by 0.45%;
- if, at the time the coupon interest is fixed, the minimum rating is Baa1/BBB+, the original coupon will be increased by 0.15%;
- ratings higher than the minimum rating do not lead to increases in the original coupon.

Under this mechanism, since October 2000 (the date the mechanism was introduced), the original coupon has been increased by 0.45% (reaching the current 6.575%).

Future upgrades/downgrades in the minimum rating could cause a decrease/increase in the coupon according to the mechanism described above.

**Convertible and exchangeable notes and bonds** outstanding amount to 489 million ( 2,519 million at December 31, 2005) and decreased by 2,030 million. The composition is as follows:

|                     | <b>As of December 31,</b> |             |
|---------------------|---------------------------|-------------|
|                     | <b>2006</b>               | <b>2005</b> |
|                     | <b>(millions of Euro)</b> |             |
| Non-current portion | 482                       | 476         |
| Current portion     | 7                         | 2,043       |

|                                       |            |              |
|---------------------------------------|------------|--------------|
| <b>Total carrying amounts</b>         | <b>489</b> | <b>2,519</b> |
| Measurement at amortized cost         | 85         | 123          |
| <b>Total nominal repayment amount</b> | <b>574</b> | <b>2,642</b> |

The nominal repayment amount of convertible and exchangeable notes and bonds totals 574 million. This shows a decrease of 2,068 million compared to December 31, 2005 ( 2,642 million) due to the repayment on maturity (March 15, 2006) of the bonds exchangeable into shares of TIM or Seat Pagine Gialle, with a carrying amount of 2,035 million at the end of 2005 and to the conversion of Telecom Italia S.p.A. 1.5% 2001-2010 convertible notes with a repayment premium ( 26 million).

The following table shows the Telecom Italia S.p.A. 1.5% 2001-2010 convertible notes with a repayment premium, expressed at the nominal repayment amount and at market value:

| Original<br>Currency                                     | Nominal<br>repayment<br>amount<br>(millions<br>of Euro) | Coupon | New share issuers     | Issue date | Maturity<br>date | Issue price<br>(%) | Market<br>price as of<br>December 31,<br>2006<br>(%) | Market<br>value<br>(millions<br>of Euro) |
|--|---|--------|-----------------------|------------|------------------|--------------------|--|--|
| <b>Convertible notes issued by Telecom Italia S.p.A.</b> |   |        |                       |            |                  |                    |  |  |
| Euro   | 574   | 1.50%  | Telecom Italia S.p.A. | 11/23/2001 | 01/01/2010       | 100                | 120.948  | 587                                      |

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Bonds issued by companies of the Group to third parties do not contain financial covenants or terms and conditions that would require the early repayment of the bonds in relation to events other than the insolvency of the Telecom Italia Group. Furthermore, the repayment of the bonds and the payment of interest are not covered by specific guarantees nor are there commitments provided relative to the assumption of future guarantees, except for the full and unconditional guarantees provided by Telecom Italia S.p.A. for the bonds issued by Telecom Italia Finance S.A. and Telecom Italia Capital S.A..

None of the securities summarized here carry any other interest rate structures or structural complexities.

Since these bonds have been placed principally with institutional investors on major world capital markets (Euromarket and the U.S.A.), the terms which regulate the bonds are in line with market practice for similar transactions effected on these same markets.

Medium/long-term **amounts due to banks** total 6,832 million ( 9,462 million at December 31, 2005) and decreased by 2,630 million mainly as a result of the early repayment of 3 billion of the Revolving Credit Facility expiring in 2012, reducing the amount drawn down to 1.5 billion, and new loans obtained from the European Investment Bank (EIB).

Short-term amounts due to banks of 906 million increased by 260 million ( 646 million at December 31, 2005) and include 625 million of the current portion of medium/long-term debt due within 12 months.

**Hedging derivatives** relating to hedged items classified as non-current assets/liabilities of a financial nature amount to 1,451 million ( 730 million at December 31, 2005). The increase is due to a negative mark to market change connected principally with the decrease in the value of the U.S. dollar against the euro and the increase in rates during 2006 which were offset by a positive change in the underlying amounts. Hedging derivatives relating to hedged items classified as current assets/liabilities total 219 million ( 185 million at December 31, 2005). Additional details are provided in the Note 24 Financial instruments .

Short-term **non-hedging derivatives** totaling 12 million ( 64 million at December 31, 2005) decreased by 52 million and refer to the measurement of derivatives which, although put into place for hedging purposes, do not possess the formal requisites to be considered as such under IFRS.

Medium/long-term **other financial payables** amount to 221 million ( 303 million at December 31, 2005). They include 127 million for the Telecom Italia Finance S.A. loan of JPY 20,000 million maturing in 2029 and 64 million of payables to the Ministry of Industry. Short-term other financial payables amount to 180 million ( 453 million at December 31, 2005) and include 43 million of payables to the *Cassa Depositi e Prestiti*, 14 million of payables to the Ministry of Industry and 86 million of payables for factoring transactions.

Medium-long term **finance lease liabilities** total 1,847 million ( 1,894 million at December 31, 2005) and mainly refer to building sale and leaseback transactions recorded in accordance with IAS 17. Short-term finance lease liabilities amount to 269 million ( 234 million at December 31, 2005).

Medium/long-term **other financial liabilities** amount to 114 million and refer to the gain that has been temporarily deferred on the sale of Avea I.H.A.S. in relation to the Telecom Italia Group's commitment to make or have a bank make a subordinated loan to Avea I.H.A.S. for U.S.\$150 million. Short-term other financial liabilities amount to 10 million ( 6 million at December 31, 2005).

At December 31, 2006, the unused credit lines of the Telecom Italia Group amount to 8,443 million ( 8,227 million at December 31, 2005) and include unused committed credit lines of 2 billion and 4.5 billion expiring, respectively, in March 2007 and in August 2012. Approximately 98% of the credit lines are denominated in euro and based on a floating interest rate.

The analysis of gross financial debt in the following tables presents discontinued operations separately.

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Gross financial debt according to the original currency of the transaction is as follows:

|  | As of December 31, 2006        |                    | As of December 31, 2005        |                    |
|--|--------------------------------|--------------------|--------------------------------|--------------------|
|  | (millions of foreign currency) | (millions of Euro) | (millions of foreign currency) | (millions of Euro) |
| USD  | 13,126                         | 9,966              | 10,351                         | 8,774              |
| GBP  | 1,782                          | 2,653              | 1,365                          | 1,991              |
| BRL  | 2,177                          | 773                | 1,898                          | 687                |
| JPY  | 20,755                         | 132                | 19,888                         | 143                |
| CHF  |                                |                    | 90                             | 58                 |
| EURO   |                                | 32,932             |                                | 40,305             |
|  |                                | <b>46,456</b>      |                                | <b>51,958</b>      |
| Discontinued operations/assets held for sale |                                |                    |                                | 143                |
|  |                                | <b>46,456</b>      |                                | <b>52,101</b>      |

The analysis of gross financial debt by effective interest rate bracket excluding the effect of derivative hedging instruments, if any, is the following:

|  | As of December 31, |               |
|--|--------------------|---------------|
|  | 2006               | 2005          |
|  | (millions of Euro) |               |
| Up to 2.5%   | 120                | 9,328         |
| From 2.5% to 5%  | 14,530             | 9,055         |
| From 5% to 7.5%  | 22,644             | 25,218        |
| From 7.5% to 10%   | 5,635              | 5,752         |
| Over 10%   | 742                | 496           |
| Accruals, prepayments and deferrals, MTM and derivatives | 2,785              | 2,109         |
|  | <b>46,456</b>      | <b>51,958</b> |
| Discontinued operations/assets held for sale             |                    | 143           |
|  | <b>46,456</b>      | <b>52,101</b> |

However, as a result of the use of derivative hedging instruments, gross financial debt by nominal interest rate bracket is the following:

|  | <b>As of December 31,</b> |               |
|--|---------------------------|---------------|
|  | <b>2006</b>               | <b>2005</b>   |
|  | <b>(millions of Euro)</b> |               |
| Up to 2.5%   | 867                       | 8,270         |
| From 2.5% to 5%  | 19,797                    | 18,883        |
| From 5% to 7.5%  | 19,587                    | 19,432        |
| From 7.5% to 10%   | 2,656                     | 2,766         |
| Over 10%   | 764                       | 498           |
| Accruals, prepayments and deferrals, MTM and derivatives | 2,785                     | 2,109         |
|  | <b>46,456</b>             | <b>51,958</b> |
| Discontinued operations/assets held for sale             |                           | 143           |
|  | <b>46,456</b>             | <b>52,101</b> |

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Gross financial debt by maturity date (divided between medium/long-term and short-term) at December 31, 2006 is as follows (carrying amounts):

|                          | <b>Medium/long<br/>term debt</b> | <b>Short-term<br/>debt</b> | <b>Total</b>  |
|--------------------------|----------------------------------|----------------------------|---------------|
|                          | (millions of Euro)               |                            |               |
| By December 31, 2007     | 5,240                            | 413                        | 5,653         |
| By December 31, 2008     | 4,466                            |                            | 4,466         |
| By December 31, 2009     | 4,280                            |                            | 4,280         |
| By December 31, 2010     | 5,352                            |                            | 5,352         |
| By December 31, 2011     | 4,618                            |                            | 4,618         |
| Beyond December 31, 2011 | 22,087                           |                            | 22,087        |
| <b>Total (*)</b>         | <b>46,043</b>                    | <b>413</b>                 | <b>46,456</b> |

(\*) The total includes accrued liabilities and deferred income which increase the amount of non-current financial liabilities due beyond December 31, 2011 by 114 million, non-current financial liabilities due within 12 months by 1,405 million and other current financial liabilities by 56 million.

\* \* \*

**Covenants and negative pledges relating to loans at December 31, 2006**

With reference to loans received by Telecom Italia S.p.A. from the European Investment Bank (EIB), the amount of 350 million, out of a total of 1,740 million at December 31, 2006, is not secured by bank guarantees and there are covenants which cover the following:

- in the event the company becomes the target of a merger, demerger or contribution of a business segment outside the Group, or sells, disposes or transfers assets or business segments, it shall immediately inform EIB which shall have the right to ask for guarantees to be provided or changes to be made to the loan contract;
- with respect to Telecom Italia's ratings (at December 31, 2006: BBB+ for S&P's, Baa2 for Moody's and BBB+ for Fitch), if the company's rating is downgraded by Standard & Poor's or Fitch Ratings, it shall immediately inform EIB which shall have the right to ask for suitable guarantees to be provided, indicating a date for setting up these guarantees. After that date and if Telecom Italia fails to provide the guarantees, EIB shall have the right to demand immediate repayment of the amount disbursed.

The syndicated bank loans of Telecom Italia do not contain financial covenants which would oblige Telecom Italia automatically to repay the outstanding loan if the covenants are not complied with. Mechanisms are provided for adjusting the cost of funding in relation to Telecom Italia's credit rating, with a spread compared to the Euribor of between a minimum of 0.12% and a maximum of

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0.33% for the line expiring in 2007, a minimum of 0.15% and a maximum of 0.425% for the line expiring in 2010 and a minimum of 0.0875% and a maximum of 0.2625% for the line expiring in 2012.

The three syndicated bank lines contain customary covenants consisting of the commitment not to change the business purpose or sell the assets of the company unless specific conditions exist (e.g. the sale takes place at fair market value). The same customary covenants are also found in the export credit loan agreements.

The syndicated bank lines (as well as an export credit agreement for a residual nominal amount of 162.8 million at December 31, 2006) contain certain change of control provisions which provide that if a party, other than the current relative majority shareholder or permitted acquiring shareholders acquire control of Telecom Italia, individually or jointly. In that case, a 30-day period is established during which the parties shall negotiate the terms with which to continue the relationship.

Lastly, for loans granted to certain companies of the Tim Brasil group, the companies must generally respect certain financial ratios (e.g. capitalization ratios, ratios for servicing debt, profit ratios and debt ratios) as well as negative pledge clauses.

At December 31, 2006, none of the covenants, negative pledge clauses or other clauses regarding the above-described debt positions have been breached or violated in any way.



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**NOTE 19 EMPLOYEE SEVERANCE INDEMNITIES AND OTHER EMPLOYEE-RELATED PROVISIONS**

Employee severance indemnities and other employee-related provisions decreased from 1,494 million at December 31, 2005 to 1,372 million. Details are as follows:

|  |              | As of<br>December 31,<br>2004 | Discontinued<br>operations/<br>assets held<br>for sale | Increases  | Decreases    | Exchange<br>differences | As of<br>December 31,<br>2005 |
|--|--------------|-------------------------------|--|------------|--------------|-------------------------|-------------------------------|
| (millions of Euro)                                   |              |                               |  |            |              |                         |                               |
| <b>Provisions for employee severance indemnities</b> | <b>(A)</b>   | <b>1,181</b>                  | <b>(4)</b>   | <b>168</b> | <b>(111)</b> |                         | <b>1,234</b>                  |
| Provisions for pension plans                         |              | 40                            | (10)   | 6          | (3)          | 1                       | 34                            |
| Provisions for termination benefit incentives        |              | 71                            |  | 234        | (79)         |                         | 226                           |
| <b>Other employee-related provisions (*)</b>         | <b>(B)</b>   | <b>111</b>                    | <b>(10)</b>  | <b>240</b> | <b>(82)</b>  | <b>1</b>                | <b>260</b>                    |
| <b>Total</b>   | <b>(A+B)</b> | <b>1,292</b>                  | <b>(14)</b>  | <b>408</b> | <b>(193)</b> | <b>1</b>                | <b>1,494</b>                  |
| <i>Of which :</i>                                    |              |                               |  |            |              |                         |                               |
| <i>Non-current portion</i>                           |              | 1,222                         |  |            |              |                         | 1,351                         |
| <i>Current portion (*)</i>                           |              | 70                            |  |            |              |                         | 143                           |

|  |              | As of<br>December 31,<br>2005 | Discontinued<br>operations/<br>assets held<br>for sale | Increases  | Decreases    | Exchange<br>differences | As of<br>December 31,<br>2006 |
|--|--------------|-------------------------------|--|------------|--------------|-------------------------|-------------------------------|
| (millions of Euro)                                   |              |                               |  |            |              |                         |                               |
| <b>Provisions for employee severance indemnities</b> | <b>(A)</b>   | <b>1,234</b>                  |  | <b>146</b> | <b>(152)</b> |                         | <b>1,228</b>                  |
| Provisions for pension plans                         |              | 34                            |  | 2          | (4)          | (1)                     | 31                            |
| Provisions for termination benefit incentives        |              | 226                           |  | 7          | (120)        |                         | 113                           |
| <b>Other employee-related provisions (*)</b>         | <b>(B)</b>   | <b>260</b>                    |  | <b>9</b>   | <b>(124)</b> | <b>(1)</b>              | <b>144</b>                    |
| <b>Total</b>   | <b>(A+B)</b> | <b>1,494</b>                  |  | <b>155</b> | <b>(276)</b> | <b>(1)</b>              | <b>1,372</b>                  |

|                            |       |       |
|----------------------------|-------|-------|
| <i>Of which :</i>          |       |       |
| <i>Non-current portion</i> | 1,351 | 1,262 |
| <i>Current portion (*)</i> | 143   | 110   |

**Provisions for employee severance indemnities** refer only to Italian companies of the Group. These provisions decreased in 2006 by 6 million mainly as a result of the accrual to the statement of income ( 146 million), utilizations for indemnities paid to employees who terminated employment, advances and transfers to pension funds ( 140 million) and other negative changes ( 12 million).

According to the law and national regulations, the amount to which each employee is entitled matures in relation to the period of service and must be paid immediately when the employee leaves the company. This severance indemnity is due upon termination of employment and is calculated in accordance with civil laws and Italian labor laws on the basis of the period of employment and the taxable income of each employee. This liability is adjusted annually based on the official cost-of-living index and interest accrued. This liability is not associated with any vesting condition or period or any funding obligation. Consequently, in accordance with IAS 19, this provision has been recognized as a defined benefit plan. Since there are no funding obligations there are no assets to service the provision.

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In accordance with IAS 19 Employee Benefits, the Projected Unit Credit Method was used to measure employee severance indemnities, as described below:

- the future possible benefits which could be paid to each employee in the event of retirement, death, disability, resignation etc. have been projected on the basis of a series of financial assumptions (cost-of-living increases, increase in remuneration etc.). The estimate of the future benefits includes any increases for additional service seniority as well as the estimated increase in the remuneration level at the measurement date;
- the *average present value of future benefits* has been calculated, at the measurement date, on the basis of the annual interest rate and on the expected payment date;
- the liability of each interested company has been determined as the average present value of future benefits for service matured by the employee at the measurement date.

The following assumptions were made:

| <b>Financial assumptions</b>                              | <b>Executives</b>  | <b>Non executives</b>  |
|---|--|--|
| Cost-of-living increases                                  | 2.2% per annum   | 2.2% per annum   |
| Discount rate   | 4.4% per annum   | 4.4% per annum   |
| Increase in remuneration:                                 |  |  |
| equal to or less than 40 years of age                     | 3.2% per annum   | 3.2% per annum   |
| over 40 years, but equal to or less than 55 years of age  | 2.7% per annum   | 2.7% per annum   |
| over 55 years of age                                      | 2.2% per annum   | 2.2% per annum   |
| <b>Demographic assumptions</b>                            | <b>Executives</b>  | <b>Non executives</b>  |
| Probability of death                                      | Mortality tables RG 48 published by Ragioneria Generale dello Stato                      | Mortality tables RG 48 published by Ragioneria Generale dello Stato                      |
| Probability of disability                                 | Unisex tables based on a study published by C.N.R. for Università di Roma reduced by 80% | Unisex tables based on a study published by C.N.R. for Università di Roma reduced by 80% |
| Probability of resignation (in relation to each company): |  |  |
| up to 40 years of age                                     | From 3.0% to 4.0% per annum  | From 3.0% to 4.0% per annum  |
| over 40 up to 50 years of age                             | From 1.5% to 2.5% per annum  | From 1.5% to 2.5% per annum  |

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| over 50 years of age                  | None                 | None                 |
|---------------------------------------|----------------------|----------------------|
| Probability of retirement:            |                      |                      |
| up to 60 years of age                 | 35% (100% for women) | 60% (100% for women) |
| over 60 but less than 65 years of age | 15% per annum        | 10% per annum        |
| at 65 years of age                    | 100%                 | 100%                 |

The adoption of the above assumptions resulted in a liability for employee severance indemnities at December 31, 2006 and 2005, respectively, of 1,228 million and 1,234 million.

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The effect on the statement of income (Personnel costs) is as follows:

|   | Year ended December 31, |            |            |
|---|-------------------------|------------|------------|
|   | 2006                    | 2005       | 2004       |
|   | (millions of Euro)      |            |            |
| Current service cost                                    | 129                     | 134        | 127        |
| Interest expense  | 49                      | 45         | 57         |
| Net actuarial (gains) losses recognized during the year | (32)                    | (11)       |            |
| <b>Total expense</b>                                    | <b>146</b>              | <b>168</b> | <b>184</b> |
| <b>Effective return on plan assets</b>                  | <b>n/a</b>              | <b>n/a</b> | <b>n/a</b> |

**Provisions for pension plans** principally refer to pension plans operating in foreign companies of the Group.

**Provisions for termination benefit incentives** include provisions both for agreements regarding mobility pursuant to Law No. 223/91, agreed in December 2005 with the labor unions, and the plan for termination incentive benefits for managers with regard to the cases currently pending.

The decreases are due to the termination of employees during the year while the increases refer to the accruals for the year 2006 ( 3 million) and the effect of the reversal of discounting the provision to present value in the 2005 financial statements ( 4 million).

**NOTE 20 PROVISIONS FOR RISKS AND CHARGES**

Provisions for risks and charges decreased from 1,569 million at December 31, 2005 to 1,355 million. The composition and changes are as follows:

|                                      | As of<br>December 31,<br>2005 | Increases | Releases to<br>the<br>statement<br>of income | Uses | Exchange<br>differences<br>and<br>other | As of<br>December 31,<br>2006 |
|--------------------------------------|-------------------------------|-----------|--|------|---|-------------------------------|
|                                      | (millions of Euro)            |           |  |      |   |                               |
| Provision for taxation and tax risks | 226                           | 64        | (21)   | (7)  |   | 262                           |

|   |              |            |              |              |              |
|---|--------------|------------|--------------|--------------|--------------|
| Provision for restoration and the decommissioning costs                           | 443          | 62         | (5)          | (113)        | 387          |
| Provision for legal disputes  | 148          | 93         | (1)          | (36)         | 206          |
| Provision for commercial risks  | 122          | 14         | (4)          | (30)         | 90           |
| Provision for risks and charges on investments and corporate-related transactions | 429          | 40         | (121)        | (29)         | 289          |
| Other provisions for risks and charges  | 201          | 18         | (5)          | (130)        | 121          |
| <b>Total</b>  | <b>1,569</b> | <b>291</b> | <b>(152)</b> | <b>(237)</b> | <b>1,355</b> |
| <i>Of which :</i>   |              |            |              |              |              |
| <i>Non-current portion</i>  | <i>797</i>   |            |              |              | <i>775</i>   |
| <i>Current portion</i>  | <i>772</i>   |            |              |              | <i>580</i>   |

**Provision for restoration and decommissioning costs** refers to the accrual for the estimated cost to decommission tangible assets and restore the sites of the Parent ( 331 million) and the companies of Brazil Mobile Business Unit ( 56 million).

This provision decreased, compared to December 31, 2005, mainly as a result of the change in the estimates of the Brazilian companies ( 105 million) and was partially countered by the increase caused by the reduction in the discount rate and the release of the effects of discounting to present value ( 37 million), offset by the increase in the number of sites leased ( 25 million).

The changes in estimate became necessary after the unit cost of restoring the sites decreased following the renewal of contracts with foreign suppliers, subsequent to the corporate reorganization of the Brazilian companies, and greater use of co-siting contracts which do not require the companies to restore the sites. These changes in estimate have been recorded with a contra-entry to tangible assets, as provided by IFRIC 1.

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**Provision for legal disputes** increased by 58 million compared to December 31, 2005 mainly due to the accrual of 61 million following the arbitration proceedings initiated by Fastweb, in March 2005, against Telecom Italia with regard to the execution of the contract for Local Loop Unbundling .

**Provision for risks and charges on investments and corporate-related transactions** decreased from December 31, 2005 principally due to the effect of:

the release to income of provisions set aside for sureties provided to banks and cancelled in September 2006 when the investment in Avea I.H.A.S. was sold ( 121 million);

the accruals for risks associated with the sales of Digitel Venezuela and Tim Hellas ( 39 million).

**Other provisions for risks and charges** decreased as a result of the payment of the fine of 115 million levied against Telecom Italia by the Antitrust Authority for the abuse of a dominant position under the Antitrust A-351 proceedings.

In 2006, exchange differences are minor in amount.

**NOTE 21 MISCELLANEOUS PAYABLES AND OTHER NON-CURRENT LIABILITIES**

Miscellaneous payables and other non-current liabilities decreased from 2,113 million at December 31, 2005 to 1,857 million at December 31, 2006 and consist of the following:

|   | <b>As of December 31,</b> |              |
|---|---------------------------|--------------|
|   | <b>2006</b>               | <b>2005</b>  |
|   | <b>(millions of Euro)</b> |              |
| Payables to social security authorities | 709                       | 881          |
| Capital grants                          | 146                       | 170          |
| Medium/long-term deferred income        | 1,002                     | 1,056        |
| Other payables and liabilities          |                           | 6            |
| <b>Total</b>                            | <b>1,857</b>              | <b>2,113</b> |

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Payables to social security authorities refer to the residual amount payable to INPS for estimated employee benefit obligations owed under Law No. 58/1992. Details are as follows:

|  | As of December 31, |              |
|--|--------------------|--------------|
|  | 2006               | 2005         |
|  | (millions of Euro) |              |
| <b>Non-current payables</b>                        |                    |              |
| Due from 2 to 5 years after the balance sheet date | 647                | 753          |
| Due beyond 5 years after the balance sheet date    | 62                 | 128          |
|  | <b>709</b>         | <b>881</b>   |
| <b>Current payables</b>                            | <b>215</b>         | <b>213</b>   |
| <b>Total</b>                                       | <b>924</b>         | <b>1,094</b> |

Medium/long-term deferred income includes 714 million (758 million at December 31, 2005) for the deferral of revenues on the activation of Telecom Italia telephone service and 261 million (265 million at December 31, 2005) on the sale of transmission capacity for future years.



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**Trade and miscellaneous payables and other current liabilities** decreased from 12,157 million at December 31, 2005 to 11,596 million. The composition is as follows:

|   | <b>As of December 31,</b> |               |
|---|---------------------------|---------------|
|   | <b>2006</b>               | <b>2005</b>   |
|   | <b>(millions of Euro)</b> |               |
| <b>Payables on construction contracts</b>   | <b>(A)</b>                | <b>2</b>      |
| <b>Trade payables:</b>  |                           |               |
| • Payables to suppliers   | 5,487                     | 6,230         |
| • Payables to other telecommunication operators   | 1,322                     | 606           |
|   | <b>(B)</b>                | <b>6,809</b>  |
| <b>Tax payables</b>   | <b>(C)</b>                | <b>550</b>    |
| <b>Miscellaneous payables and other current liabilities:</b>  |                           |               |
| • Payables for employee compensation  | 524                       | 712           |
| • Payables to social security authorities   | 381                       | 375           |
| • Trade and miscellaneous deferred income   | 832                       | 821           |
| • Advances received   | 48                        | 64            |
| • Customer-related items  | 1,434                     | 1,465         |
| • Payables for the TLC operating fee  | 35                        | 39            |
| • Dividends approved, but yet to be paid to shareholders  | 24                        | 22            |
| • Other current liabilities   | 267                       | 306           |
| • Employee-related reserves (except for Employee severance indemnities) expected to be settled within 12 months | 110                       | 143           |
| • Other provisions for risks and charges, expected to be settled within 12 months                               | 580                       | 772           |
|   | <b>(D)</b>                | <b>4,235</b>  |
| <b>Total</b>  | <b>(A+B+C+D)</b>          | <b>11,596</b> |
|   |                           | <b>12,157</b> |

**Trade payables** (all due within 12 months) refer to Telecom Italia ( 4,762 million) and to the Tim Brasil group ( 950 million). The increase in payables to other telecommunications operators, compared to December 31, 2005, is related to the previously-mentioned different representation of the corresponding receivables position (please see Note 11-Trade and miscellaneous receivables and other current assets ).

**Tax payables** particularly refer to the Parent for a total of 369 million (including VAT payable for 181 million and the government concession tax for 98 million) and to the Brazilian mobile telephone companies for 125 million.

**Payables to social security authorities** include the short-term portion of the amount payable to INPS under Law No. 58 for 215 million ( 213 million at December 31, 2005) as described in the Note 21 Miscellaneous payables and other non-current liabilities .

**Deferred income** mainly refers to the Parent and includes 282 million ( 282 million at December 31, 2005) for the deferral of revenues from the activation of telephone service (current portion) and 38 million ( 38 million at December 31, 2005) for the deferral of revenues from recharging prepaid telephone cards.

#### **NOTE 23 CURRENT INCOME TAX PAYABLES**

**Current income tax payables** amount to 219 million ( 227 million at December 31, 2005) and mainly include IRAP taxes payable by Telecom Italia ( 102 million) and IRES taxes payable by Telecom Italia Sparkle ( 72 million) which are not included in the national consolidated tax return filed by the Telecom Italia Group.

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The majority of non-current financial liabilities of the Telecom Italia Group consist of bonds and their measurement at fair value can be easily determined since they are represented by financial instruments which, because of their size and diffusion among investors, are frequently exchanged on the markets (see the Note 18 Financial liabilities (current and non-current) ). Instead, for other types of loans, where there is no public trading, the following assumptions were made:

- the floating-rate loans were considered at the nominal repayment amount;
- the fixed-rate loans were measured at fair value (present value of future flows using December 31, 2006 market rates).

Finally, the carrying amount of most of the financial assets represents a reasonable approximation of their fair value as they are highly liquid short-term financial investments.

Fair values (accruals included) of financial liabilities and financial assets at December 31, 2006 and at December 31, 2005 are set out below:

| <b>Financial liabilities</b>                        | <b>As of December 31, 2006</b> |  | <b>As of December 31, 2005</b> |  |
|---|--------------------------------|--|--------------------------------|--|
|   | <b>Carrying amounts</b>        | <b>Fair values (included accruals)</b> | <b>Carrying amounts</b>        | <b>Fair values (included accruals)</b> |
|   |                                | <b>(millions of Euro)</b>              |                                |  |
| Notes and bonds                                     | 33,906                         | 34,478                                 | 35,462                         | 37,427                                 |
| Convertible and exchangeable notes and bonds        | 489                            | 701                                    | 2,519                          | 2,680                                  |
| Drawn bank Facility                                 | 4,549                          | 4,567                                  | 7,535                          | 7,574                                  |
| Loans, other debt and finance lease liabilities     | 7,512                          | 7,616                                  | 6,442                          | 6,509                                  |
|   | <b>46,456</b>                  | <b>47,362</b>                          | <b>51,958</b>                  | <b>54,190</b>                          |
| <b>Discontinued operations/assets held for sale</b> |                                |  | <b>143</b>                     | <b>143</b>                             |
| <b>Total Gross Financial Debt</b>                   | <b>46,456</b>                  | <b>47,362</b>                          | <b>52,101</b>                  | <b>54,333</b>                          |

| <u>Financial assets</u>                                     | <u>As of December 31, 2006</u> |  | <u>As of December 31, 2005</u> |  |
|---|--------------------------------|--|--------------------------------|--|
|   | <u>Carrying amounts</u>        | <u>Fair values (included accruals)</u> | <u>Carrying amounts</u>        | <u>Fair values (included accruals)</u> |
|   | (millions of Euro)             |  |                                |  |
| Deposits and cash   | 7,191                          | 7,191                                  | 9,958                          | 9,958                                  |
| Euro Commercial Paper                                       | 20                             | 20                                     | 327                            | 327                                    |
| Deposits for temporary investments maturing beyond 3 months | 17                             | 17                                     | 90                             | 90                                     |
| Securities  | 831                            | 831                                    | 390                            | 390                                    |
| Other receivables   | 1,096                          | 1,096                                  | 1,441                          | 1,441                                  |
|   | <u>9,155</u>                   | <u>9,155</u>                           | <u>12,206</u>                  | <u>12,206</u>                          |
| <b>Discontinued operations/assets held for sale</b>         |                                |  | <b>37</b>                      | <b>37</b>                              |
|   | <u>9,155</u>                   | <u>9,155</u>                           | <u>12,243</u>                  | <u>12,243</u>                          |
| <b>Total Financial Assets</b>                               | <b>9,155</b>                   | <b>9,155</b>                           | <b>12,243</b>                  | <b>12,243</b>                          |

**DERIVATIVES**

Derivative financial instruments are used by the Telecom Italia Group to manage its exposure to foreign currency and interest rate risks and to diversify the parameters of debt so that costs and volatility can be reduced to within predetermined operational limits.

Derivative financial instruments at December 31, 2006 are principally used to manage debt positions. They include interest rate swaps (IRS) to reduce interest rate exposure on fixed-rate and floating-rate bank loans and bonds, as well as cross currency and interest rate swaps (CCIRS) and currency forwards to convert the loans secured in different foreign currencies to the functional currencies of the various companies of the Group.

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IRSs involve, at specified maturity dates, the exchange of flows of interest calculated on the notional amount at the agreed fixed or floating rates, with the counterparts.

The same also applies to CCIRSs which, in addition to the settlement of periodic interest flows, can involve the exchange of principal, in the respective currencies of denomination, at maturity and at another date.

The following tables show the derivative transactions put into place by the Telecom Italia Group at December 31, 2006 divided between Fair Value Hedge Derivatives (Table 1 Fair Value Hedge Derivatives), Cash Flow Hedge Derivatives (Table 2 Cash Flow Hedge Derivatives) and Non-Hedge Accounting Derivatives (Table 3 Non-Hedge Accounting Derivatives) under IAS 39:

**Table 1 Fair Value Hedge Derivatives**

| <b>Description</b>  | <b>Equivalent notional amount</b> | <b>Mark to market (Clean Price)</b> |
|---|-----------------------------------|-------------------------------------|
|   | <b>(millions of Euro)</b>         |                                     |
| CCIRS transactions put into place by Telecom Italia S.p.A. maturing April 2007 on an EIB loan in U.S.\$180 million (equivalent amount of 136 million at December 31, 2006)  | 150                               | (14)                                |
| CCIRS transactions put into place by Telecom Italia S.p.A. maturing June 2007 on Telecom Italia S.p.A. bonds amounting to GBP 850 million (equivalent amounts of 1,266 million at December 31, 2006) issued on June 2004  | 1,289                             | (23)                                |
| CCIRS transactions put into place by Telecom Italia S.p.A. maturing November 2008 on the five year tranche of U.S.\$1,000 million (equivalent amounts of 759 million at December 31, 2006) on the bonds issued in October 2003 by Telecom Italia Capital S.A. for a total amount of U.S.\$4,000 million   | 850                               | (114)                               |
| CCIRS transactions put into place by Telecom Italia S.p.A. maturing May 2032 on Telecom Italia Finance S.A. bonds amounting to Japanese yen 20 billion (equivalent amounts of 127 million at December 31, 2006) originally issued by Olivetti Finance N.V.S.A. (2002-2032)  | 171                               | (80)                                |
| CCIRS transactions put into place by Telecom Italia Capital S.A. on the bonds issued by Telecom Italia Capital S.A. in October 2004 for a total amount of U.S.\$3,500 million (equivalent amounts of 2,658 million at December 31, 2006), including five-year tranche for U.S.\$1,250 million, ten-year tranche for U.S.\$1,250 million and thirty-year tranche for U.S.\$1,000 million | 2,831                             | (295)                               |
| CCIRS transactions put into place by Telecom Italia Capital S.A. on the bonds issued by Telecom Italia Capital S.A. in September 2005 for a total amount of U.S.\$2,500 million (equivalent amounts of 1,898 million at December 31, 2006), including five-year tranche for U.S.\$700 million, 5.35-year tranche for U.S.\$400 million and ten-year tranche for U.S.\$1,400 million     | 2,068                             | (223)                               |
|   | 1,264                             | (38)                                |

CCIRS transactions put into place by Telecom Italia Capital S.A. maturing in July 2011 on bonds issued by Telecom Italia Capital S.A. in July 2006 for a total amount of U.S.\$2,600 million on the two 5-year tranches for a total of U.S.\$1,600 million (equivalent amount of 1,215 million at December 31, 2006)

|   |              |              |
|---|--------------|--------------|
| <b>Total Fair Value Hedge Derivatives</b> | <b>8,623</b> | <b>(787)</b> |
|---|--------------|--------------|

- On the EIB loan for U.S.\$180 million, maturing April 2007, Telecom Italia S.p.A. finalized a CCIRS contract for 150 million converting a 3-month Libor in U.S.\$ to the 3-month Euribor.
- On the bonds of GBP 850 million issued by Telecom Italia S.p.A. in June 2004, Telecom Italia S.p.A. put into place CCIRS contracts for 1,289 million maturing June 2007, converting the GBP annual fixed rate of 6.375% to Euribor.
- On the tranche maturing in November 2008 for U.S.\$1,000 million relating to the bonds issued in October 2003 by Telecom Italia Capital S.A. for a total amount of U.S.\$4,000 million, Telecom Italia S.p.A. put in place CCIRS contracts of 850 million converting the coupon rate of 4% in U.S.\$ to 3-month Euribor.

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- For 171 million, on the bonds 2002-2032 of JPY 20 billion with a 3.55% fixed rate coupon maturing May 2032, originally issued by Olivetti Finance N.V.S.A., the following transactions were put into place:

by Telecom Italia Finance S.A., an IRS contract in which Telecom Italia Finance S.A. receives the semiannual coupon of 3.55% in JPY and pays a semiannual floating rate in JPY;

by Telecom Italia S.p.A., a CCIRS contract, on a floating rate intragroup loan in JPY, in which Telecom Italia S.p.A. receives 6-month Libor in JPY and pays 6-month Euribor.

- On the bonds of U.S.\$3,500 million issued by Telecom Italia Capital S.A. in October 2004, Telecom Italia Capital S.A. put in place CCIRS contracts for 2,831 million converting the coupon rate in U.S.\$ to the 6-month Euribor.
- On the bonds of U.S.\$2,500 million issued by Telecom Italia Capital S.A. in September 2005, Telecom Italia Capital S.A. put in place CCIRS contracts for 2,068 million converting the coupon rate in U.S.\$ to the 6-month Euribor.
- On the two tranches maturing July 2011 for U.S.\$1,600 million of bonds for a total of U.S.\$2,600 million issued by Telecom Italia Capital S.A. in July 2006, Telecom Italia Capital S.A. put into place CCIRS contracts for 1,264 million converting the coupon rate (respectively, of 6.2% in U.S.\$ and the 3-month U.S.\$ Libor + 0.61%) to the 6-month Euribor.

**Tab. 2 Cash Flow Hedge Derivatives**

| <u>Description</u>   | <u>Notional amount</u> | <u>Mark to Market (Clean Price)</u> |
|--|------------------------|-------------------------------------|
|  | (millions of Euro)     |                                     |
| Forward purchase transactions of U.S.\$3 million (equivalent amount of 2 million at December 31, 2006) put into place by Telecom Media News S.p.A. with monthly maturities between January 2007 and December 2008  | 2                      |                                     |
| U.S.\$ Call / EUR Put options purchased by Telecom Media News S.p.A. maturing December 2009, December 2010 and February 2011   | 3                      |                                     |
| Commodity swaps put into place by Telecom Italia S.p.A. on behalf of Telenergia S.r.l. for the purchase of electrical energy in 2007   | 89                     | (6)                                 |
| IRS transactions put into place by Telecom Italia S.p.A. maturing March 2009 on notes of 110 million issued by Telecom Italia S.p.A. (2004-2009)   | 110                    | 3                                   |
| IRS transactions put into place by Telecom Italia S.p.A. maturing January 2010 on five-year tranche C of the Term Loan for a total amount of 12,000 million finalized in December 2004 in connection with Cash Tender Offer by Telecom Italia for TIM shares | 3,000                  | 88                                  |
|  | 1,709                  | (267)                               |

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|  |       |     |
|--|-------|-----|
| CCIRS transactions put into place by Telecom Italia S.p.A. maturing November 2013 on ten-year tranche for a total amount of U.S.\$2,000 million (equivalent amount of 1,519 million at December 31, 2006) on the bonds issued by Telecom Italia Capital S.A. in October 2003 for a total amount of U.S.\$4,000 million |       |     |
| IRS transactions put into place by Telecom Italia S.p.A. maturing November 2015 on bonds of 120 million issued by Telecom Italia S.p.A. (2004-2015)  | 120   | 6   |
| CCIRS transactions put into place by Telecom Italia S.p.A. maturing December 2015 on bonds of GBP 500 million (equivalent amount 745 million at December 31, 2006) issued by Telecom Italia S.p.A. in June 2005  | 751   | 13  |
| CCIRS transactions put into place by Telecom Italia S.p.A. starting June 2007 and maturing June 2019 on bonds of GBP 850 million (equivalent amount of 1,266 million at December 31, 2006) issued by Telecom Italia S.p.A. in June 2004  | 1,258 | 15  |
| CCIRS transactions put into place by Telecom Italia S.p.A. maturing May 2023 on bonds of GBP 400 million (equivalent amount of 596 million at December 31, 2006) issued by Telecom Italia S.p.A. in May 2006   | 587   | (3) |

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|---|--|---------------------------------------|
| Description   | Notional<br>amount                         | Mark to<br>Market<br>(Clean<br>Price) |
|   | (millions of Euro)                         |                                       |
| IRS transaction put into place by Telecom Italia S.p.A. maturing December 2010 on floating-rate notes of 1,000 million issued by Telecom Italia S.p.A. in December 2005 and maturing December 2012  | 1,000                                      | 5                                     |
| CCIRS transactions put into place by Telecom Italia S.p.A. maturing October 2029 related to the Telecom Italia Finance S.A. the Dual-Currency loan with a notional principal of Japanese yen 20 billion (equivalent amount of 127 million at December 31, 2006) originally received by Olivetti International Finance N.V | 174  | (72)                                  |
| CCIRS transactions put into place by Telecom Italia S.p.A. maturing November 2033 on thirty-year tranche for a total amount of U.S.\$1,000 million (equivalent amount of 759 million at December 31, 2006) on the bonds issued by Telecom Italia Capital S.A. in October 2003 for a total amount of U.S.\$4,000 million   | 849  | (202)                                 |
| CCIRS transactions put into place by Telecom Italia S.p.A. maturing July 2036 on the 30-year tranche of U.S.\$1,000 million (equivalent amount of 759 million at December 31, 2006) on the bonds issued by Telecom Italia Capital S.A. in July 2006 for a total amount of U.S.\$2,600 million                             | 791  | (22)                                  |
| <b>Total Cash Flow Hedge Derivatives</b>  | <b>10,443</b>                              | <b>(442)</b>                          |

- Forward purchase transactions in U.S.\$, for an equivalent amount of 2 million, put into place by Telecom Media News S.p.A. to hedge the exchange rate risk on the commitment to make monthly payments in U.S.\$ from January 2007 to December 2008.
- U.S.\$ call / EUR put options, for an equivalent amount of 3 million, purchased by Telecom Media News S.p.A. to hedge the exchange rate risk on the commitment to make monthly payments in U.S.\$ from January 2009 to February 2011.
- Commodity swaps for 89 million by which Telenergia S.r.l. set the price for a part of the energy purchased at 56.10 per MWh (fixed weighted average price). The contract expires in December 31, 2007.
- On the notes 2004-2009 of 110 million at a quarterly floating rate issued by Telecom Italia S.p.A. maturing March 2009, Telecom Italia S.p.A. put into place an IRS contract converting the 3-month Euribor to an annual fixed rate of 3.35%.
- In reference to the term loan for a total amount of 12,000 million finalized in December 2004 in connection with the cash tender offer for TIM S.p.A., Telecom Italia S.p.A. put into place IRS contracts for a total amount of 3,000 million converting the 6-month Euribor on tranche C to an annual fixed rate of 3.088%, maturing January 2010.
- On the tranche maturing in November 2013 of U.S.\$2,000 million relating to the bonds issued in October 2003 by Telecom Italia Capital S.A. for a total amount of U.S.\$4,000 million, Telecom Italia S.p.A. put into place CCIRS contracts for 1,709 million converting the coupon rate of 5.25% in U.S.\$ to a fixed rate of 5.035% in euro.
-

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On the bonds of 120 million at a quarterly floating rate issued by Telecom Italia S.p.A. maturing November 2015, Telecom Italia S.p.A. put into place IRS contracts converting the 3-month Euribor to an annual fixed rate of 4.161%.

- On the bonds 2005-2015 of GBP 500 million issued by Telecom Italia S.p.A. in June 2005, Telecom Italia S.p.A. put into place CCIRS contracts for 751 million converting a rate of 5.625% in GBP to a fixed rate of 4.34% in euro.
- On the GBP 850 million bonds issued by Telecom Italia S.p.A. in June 2004, Telecom Italia S.p.A. put into place CCIRS contracts for 1,258 million, converting the fixed rate of 6.375% in GBP to a fixed rate of 5.31% in euro, starting June 2007 and maturing June 2019.

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- On the bonds 2006-2023 of GBP 400 million issued by Telecom Italia S.p.A. in May 2006, Telecom Italia S.p.A. put into place CCIRS contracts for 587 million converting a rate of 5.875% in GBP to a fixed rate of 5.53% in euro.
- On the notes 2005-2012 of 1,000 million issued by Telecom Italia S.p.A. in December 2005, Telecom Italia S.p.A. put into place IRS contracts converting the Euribor + 0.53% coupon rate to a fixed rate of 4.54% in euro up to December 2010.
- For 174 million, with reference to the Telecom Italia Finance S.A. Dual Currency loan with a notional principal of JPY 20 billion and a 5% fixed interest rate with a step-up of +0.45% in U.S.\$ maturing October 2029, originally received by Olivetti International Finance N.V., equivalent to 127 million at December 31, 2006, the following was put in place:
  - by Telecom Italia Finance S.A., an IRS contract converting the 5% fixed rate in U.S.\$ to the 6-month Libor in JPY;
  - by Telecom Italia S.p.A., a CCIRS contract with which Telecom Italia S.p.A., with regard to the intragroup loan in JPY, receives 6-month Libor in JPY and pays 6-month Euribor;
  - by Telecom Italia S.p.A. an IRS contract converting the semiannual floating rate in euro to a 6.94% fixed rate up to maturity.
- On the tranche of U.S.\$1,000 million maturing in November 2033 relating to the bonds issued in October 2003 by Telecom Italia Capital S.A. for a total amount of U.S.\$4,000 million, Telecom Italia S.p.A. put in place CCIRS contracts for 849 million converting the rate of 6.375% in U.S.\$ to the fixed rate of 6% in euro.
- On the tranche of U.S.\$1,000 maturing in July 2036 relating to the bonds issued in July 2006 by Telecom Italia Capital S.A. for a total of U.S.\$2,600 million, Telecom Italia S.p.A. put into place CCIRS contracts for 791 million converting the rate of 7.20% in U.S.\$ to the fixed rate of 5.88% in euro.

The method used to test the effectiveness, retrospectively and prospectively, of Fair Value Hedge instruments and Cash Flow Hedge instruments is the Volatility Risk Reduction (VRR) Test. This test assesses the ratio between the portfolio risk (where the portfolio means the hedging instrument and the item hedged) and the risk of the hedged item taken separately. In short, the portfolio risk must be less than the risk of the item hedged:

$$\text{VRR} = 1 \quad (\text{portfolio risk} / \text{risk of the hedged item})$$

The better the hedging ratio, the more VRR tends to the value 1. To establish if a hedge is effective, this ratio must be higher than the threshold over which the test identifies the hedging as highly effective as required by IFRS.

**Tab. 3 Non-Hedge Accounting Derivatives**

| <u>Description</u>   | <u>Equivalent<br/>notional<br/>amount</u> | <u>Mark to<br/>Market<br/>(Clean<br/>Price)</u> |
|--|---|---|
|  | (millions of Euro)                        |   |
| Floating to floating IRS contracts put into place by Telecom Italia S.p.A.     | 22  |   |
| FRA contracts put into place by Telecom Italia S.p.A. maturing January 2007    | 593                                       |   |
| FRA contracts put into place by Telecom Italia S.p.A. maturing March 2007      | 806                                       | 1   |
| FRA contracts put into place by Telecom Italia S.p.A. maturing July 2007       | 593                                       |   |
| FRA contracts put into place by Telecom Italia S.p.A. maturing September 2007  | 806                                       | 1   |
| Interest rate and foreign exchange contracts put into place by Group companies | 366                                       | 4   |
| <b>Total Non-Hedge Accounting Derivatives</b>                                  | <b>3,186</b>                              | <b>6</b>  |

- The floating to floating IRS contracts put in place by Telecom Italia S.p.A. for a notional amount of 22 million convert interest on loans indexed on domestic parameters (Rendint, Rolint and Robot) with conversion to the 6-month Euribor.

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- Purchase of Forward Rate Agreements (FRA):

for a notional amount of 593 million, through which in January 2007 Telecom Italia S.p.A. will receive the 6-month Euribor at the January 2007 fixing and will pay a fixed rate of 3.83% relating to a period of 6 months. The FRAs purchased are for the management of risks associated with a possible increase in the short-term rates in euro;

for a notional amount of 806 million, through which in March 2007 Telecom Italia S.p.A. will receive the 6-month Euribor at the March 2007 fixing and will pay a fixed rate of 3.91% relating to a period of 6 months. The FRAs purchased are for the management of risks associated with a possible increase in the short-term rates in euro;

for a notional amount of 593 million, through which in July 2007 Telecom Italia S.p.A. will receive the 6-month Euribor at the July 2007 fixing and will pay a fixed rate of 3.99% relating to a period of 6 months. The FRAs purchased are for the management of risks associated with a possible increase in the short-term rates in euro;

for a notional amount of 806 million, through which in September 2007 Telecom Italia S.p.A. will receive the 6-month Euribor at the September 2007 fixing and will pay a fixed rate of 3.91% for 6 months. The FRAs purchased are for the management of risks associated with a possible increase in the short-term rates in euro.

- Interest rate and foreign exchange contracts amount to 366 million, of which 88 million are carried by companies in Brazil.

The following table shows the derivative financial instruments of the Telecom Italia Group by type:

| Type                                      | Hedged risk  | Notional amount | Mark to Market Spot (Clean Price) as of December 31, 2006 | Mark to Market Spot (Clean Price) as of December 31, 2005 |
|---|--|-----------------|---|---|
| (millions of Euro)                        |  |                 |   |   |
| Interest Rate Swaps                       | Interest Rate Risk   |                 |   |   |
| Cross Currency and Interest Rate Swaps    | Interest Rate Risk and Foreign Currency Exchange Rate Risk | 8,623           | (787)   | (62)  |
| <b>Total Fair Value Hedge Derivatives</b> |  | <b>8,623</b>    | <b>(787)</b>  | <b>(62)</b>   |
| Interest Rate Swaps                       | Interest Rate Risk   | 4,230           | 102   | 13  |
| Cross Currency and Interest Rate Swaps    | Interest Rate Risk and Foreign Currency Exchange Rate Risk | 6,119           | (538)   | (405)   |
| Commodity Swap                            | Commodity Risk   | 89              | (6)   |   |
| Forward and Forex Options                 | Foreign currency exchange rate risk                        | 5               |   |   |
| <b>Total Cash Flow Hedge Derivatives</b>  |  | <b>10,443</b>   | <b>(442)</b>  | <b>(392)</b>  |

|   |               |                |              |
|---|---------------|----------------|--------------|
| <b>Non-Hedge Accounting Derivatives</b>       | <u>3,186</u>  | <u>6</u>       | <u>(19)</u>  |
| <b>Total Telecom Italia Group Derivatives</b> | <u>22,252</u> | <u>(1,223)</u> | <u>(473)</u> |

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The following table shows, for Cash Flow Hedge Derivatives, the amount recognized in the Reserve for fair value adjustments to hedging derivatives during 2006 and the portion reversed from the reserve to the statement of income as an exchange rate adjustment, before the relative tax effect:

| Description                        | Reserve for fair value adjustments to Cash Flow Hedge derivatives at December 31, 2006 | Reserve for fair value adjustments to Cash Flow Hedge derivatives at December 31, 2005 | Mark to Market change recognized in the Reserve for fair value adjustments to hedging derivatives | Amount reversed from the Reserve for fair value adjustments to hedging derivatives to the statement of income as an exchange rate adjustment | Impact of Cash Flow Hedge derivatives in 2006 on the Reserve for fair value adjustments to hedging derivatives |
|------------------------------------|--|--|---|--|--|
|                                    |  |  | (millions of Euro)  |  |  |
| <b>Cash Flow Hedge Derivatives</b> | <b>(69)</b>  | <b>(311)</b>   | <b>(48)</b>   | <b>290</b>   | <b>242</b>   |

**NOTE 25 FINANCIAL ASSETS PLEDGED AS COLLATERAL FOR FINANCIAL LIABILITIES**

The contracts for subsidized loans granted by the Brazilian development bank BNDES (Banco Nacional de Desenvolvimento Econômico e Social) to certain operating companies of the Tim Brasil Serviços e Participações S.A. group for a total equivalent amount of 434 million are guaranteed by a part of the receipts of those companies which pass through bank accounts that are pledged in favor of BNDES. The bank will have access to such amounts only in the case of default by the company, otherwise the funds will be automatically transferred to accounts on which the company has full access.

**NOTE 26 CONTINGENT ASSETS AND LIABILITIES, COMMITMENTS AND OTHER GUARANTEES**

The main legal and arbitration proceedings in which companies of the Telecom Italia Group were involved as of December 31, 2006 are described below. Except where explicitly mentioned, provisions have not been made, as there is not an adequate objective basis for doing so or because a negative outcome of the dispute is considered unlikely.

**a) Contingent liabilities****TAX AUDIT OF BLU**

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On January 26, 2007 Telecom Italia received the report containing the Revenue Agency's preliminary findings of the tax audit of the 2002 merger of Blu into TIM.

The audit began in July 2004 for financial years 2000 (only for purposes of value-added tax) and 2002 (for both value-added tax and income taxes) of Blu. In March 2005, the Revenue Agency extended the audit to TIM's 2002 financial year and the tax consequences of the merger, whose tax effects were backdated to January 1 of that year.

Blu was the subject of a complex break-up operation, carried out with the full accord of the Government and the various regulatory authorities involved, that entailed the transfer of three distinct business units from Blu to Wind, Vodafone-Omnitel and H3G, respectively, and the transfer of 100% of its share capital to TIM.

Towards the end of 2002, TIM, because of the business reasons underlying the merger, petitioned the tax authorities not to apply the anti-avoidance provisions of the tax law, which would have prevented TIM from using Blu's prior-year tax losses (amounting to 857 million). The tax authorities in a ruling dated March 6, 2003, allowed the waiver on the basis of anti-avoidance rules.

The Revenue Agency increased its focus on this matter during their audit and the above-mentioned waiver has been challenged on the basis that the merger of Blu had not created the business synergies and values suggested in the petition. The Revenue Agency claims that the petition had given an incomplete or even misleading description of the terms of the transaction and that such transaction should be considered as a tax avoidance scheme.



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On these grounds, the report of preliminary findings sets out the following assessments (which would involve additional income taxes totaling 465 million in connection with TIM's 2002 financial year):

- *First assessment:* disallowance of the tax saving (156 million) resulting from the backdating of the merger;
- *Second assessment:* disallowance of the right to use Blu's prior-year tax losses (corresponding to 309 million in terms of additional taxes due).

The rationale for both assessments is the alleged tax-avoidance purpose of the whole transaction, the consequence being not only the (unprecedented) revocation of the ruling already issued by the Revenue Agency but also, in connection with the first assessment, the denial of the tax deduction arising from the retroactivity of the merger. In addition, the report alleges that the write-downs and losses deducted for tax purposes by the former shareholders of Blu in relation with their investment, before the sale to TIM, would in any case reduce the prior-year losses of Blu that could be utilized by Tim by an equal amount (625 million in total) inasmuch as the tax rule designed to prevent double deduction of losses is in the nature of a systematic rule, not an anti-avoidance provision, and therefore cannot be waived upon request of the taxpayer.

In relation to this entire matter the Company, based on authoritative opinions, considers that it can validly appeal in all the administrative and, if necessary, civil courts, and accordingly has not deemed it appropriate to make any provisions in the financial statements.

The Turin Office of the Revenue Agency must evaluate the validity of the objections and of the Company's replies before deciding whether and for what amount to proceed with the assessment.

A copy of the report has been transmitted to the public prosecutor at the Turin Court.

**FASTWEB**

In December 2006 Fastweb notified Telecom Italia of the start of an arbitration proceeding under the arbitration clause of the interconnection contract concluded between the parties in January 2000, alleging non-performance in connection with the fixed-mobile termination fees charged from January 1, 2000 to the end of November 2006.

Specifically, Fastweb asserts that Telecom Italia violated the obligation, imposed by the regulations in force on firms with dominant market power, to apply cost-related, non-discriminatory fees. The consequent request for damages amounts to approximately 70 million.

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In December 2006 Fastweb also notified Telecom Italia that it had sent a petition to the National Regulatory Authority under Article 23 of the Communications Code and Resolution 148/01/CONS (for the resolution of disputes between operators) claiming the termination charges on Telecom Italia's mobile network to be invalid and therefore no longer applicable, and requesting the Authority to establish new termination charges in conformity with the regulations in force.

Telecom Italia filed a counterclaim in the arbitration proceeding, challenging Fastweb's statements.

\* \* \*

In January 2007 the award was issued in the arbitration proceeding initiated by Fastweb in 2005 for alleged non-performance by Telecom Italia of the contract for the supply of unbundled local access services (Local Loop Unbundling). The arbitration board recognized non-performance and ordered the Company to pay damages of approximately 61 million. A specific provision has been made in the financial statements for 2006.

The dispute concerned a claim by Fastweb for 168 million of damages in relation to more than 21,000 customers who were allegedly taken away by Telecom Italia between 2002 and 2005 as a result of non-activation of unbundled lines. The award ascertained non-performance by the Company in about 11,000 cases, compared with a total of some 550,000 requests by Fastweb for activation of unbundling in the period considered (up to April 30, 2005). The Company intends to challenge the award before the Rome Court of Appeal.

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In November 2006 Fastweb initiated a proceeding before the Milan Court of Appeal to have Telecom Italia pay damages of 522 million resulting from violations already punished by the Antitrust Authority in Case A-351 (which ended with Telecom Italia being ordered to pay a fine of 115 million for anti-competitive conduct).

Telecom Italia has defended the case, arguing that Fastweb's requests are unfounded and inadmissible.

\* \* \*

Still pending is the arbitration proceeding that Telecom Italia initiated in December 2005 with Fastweb (concerning inverse termination) with a view to obtaining a decision recognizing: (i) that Fastweb had breached the interconnection contract concluded on January 28, 2000 by unilaterally altering the economic conditions for termination on Fastweb's fixed network of traffic developed towards geographical numbers; (ii) that the value of termination on the Fastweb network be determined in accordance with the principle of reciprocity; and (iii) that Telecom Italia did not owe the larger sums requested by Fastweb applying its self-determined termination charges.

Specifically, Telecom Italia seeks to obtain a decision finding that Fastweb breached the January 2000 interconnection contract and consequently recognizing the applicability, for termination on Fastweb's fixed network in the period from January 1, 2004 to June 30, 2006, of the contractual price (0.55 per minute) instead of the higher price that Fastweb demanded and billed (2.71 per minute). The time limit for the publication of the arbitration award will expire on May 31, 2007.

**EUTELIA**

In January 2007, Eutelia S.p.A. brought an action against Telecom Italia, claiming damages of 50 million in relation to the omission from Telecom Italia bills, in the space reserved to telephone traffic towards special numbers, of the name of the new operator (Voiceplus) to which the numbers to these value-added services previously assigned to Eutelia, had consequently been transferred.

According to Eutelia, Telecom Italia omitted the new assignee's name from the telephone bills it sent to its own subscribers with a view to harming Eutelia's image and business reputation. Eutelia asserts that as a consequence of the omission it is involved in disputes initiated by final users who contend they never requested the telephony services supplied by Voiceplus.

Telecom Italia intends to defend the case, disputing Eutelia's claims.

\* \* \*

In January 2007, Eutelia brought a further action claiming damages of not less than 40 million in relation to alleged abuse of dominant position by Telecom Italia in the form of illegitimately disconnecting the lines of customers of the operator Grapes Network Services Srl who were about to move over to Eutelia as a result of the transfer to Eutelia of the contracts for voice and data transmission with business and retail customers from the Grapes Network Services Srl.

Telecom Italia intends to defend the case, disputing Eutelia's claims.

\* \* \*

Furthermore, in February 2007, Eutelia also brought an action before the Milan Court of Appeal against Telecom Italia for alleged abuse of dominant position in the markets for access to the switched and voice telephony networks, related to the offer called Casa Vacanza .

The alleged abuses consist, in general, of charging an unjustifiably high fee for the basic telephone line and applying a below-cost fee for additional telephone lines in the name of the same customer (with the Casa Vacanza offer), and, lastly, in coupling (with the Hello Gratis offer) an hour and half of free traffic every two months with the access service (i.e. the subscription fee).

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In essence, Eutelia alleges that the subscription fee for the basic residential line (currently 14.57 per month) generates monopoly excessive profits enabling Telecom Italia to compensate for the costs of access services for the customer's principal line, subsidize the cost of the access service for the same customer's secondary lines and finance the costs of the hour and half of traffic offered free of charge every two months for all the lines held by the same customer. Eutelia claims damages of 150 million.

Telecom Italia intends to defend the case, arguing that Eutelia's claims are unfounded.

\* \* \*

The proceeding initiated by Eutelia in December 2005 with an urgent petition filed pursuant to Article 700 of the Italian Code of Civil Procedure and Article 33 of Law No. 287/1990 claiming abusive conduct by Telecom Italia on the broadband access markets is still pending. The alleged abuses consisted of the non-execution or delayed execution by Telecom Italia of requests to activate Eutelia's ADSL service for Eutelia's customers or in the activation of Telecom Italia's ADSL service for customers who had not requested it, thereby preventing them from using the ADSL service offered by Eutelia. In addition, Eutelia asserts that Telecom Italia's refusal to activate so-called data only ADSL lines inasmuch as these were separate from the telephony service offered by Telecom Italia constituted an abuse of dominant position. Eutelia claims total damages of 40 million.

Telecom Italia is defending the case, arguing that Eutelia's claims are without merit.

\* \* \*

A proceeding initiated by Eutelia in November 2006 before the Milan Court of Appeal is also still pending. Eutelia alleges that Telecom Italia committed abuses on the broadband access market by applying anti-competitive prices to Eutelia and has claimed damages, to be quantified, for alleged losses. Telecom Italia has disputed Eutelia's allegations and has requested that this proceeding be brought together with that initiated by Eutelia in December 2005, described in the preceding paragraph.

**NHAI**

The action brought by Nhai S.r.l. (formerly Help S.p.A.) in September 2005 is still pending. Nhai's purpose in bringing the action was to establish that in the first half of the 1990s Telesoft (subsequently merged into Telecom Italia), in its capacity as a member of the CREATT, a Consortium for Automatic Telephone Traffic Data Collection and Processing, (whose participants included the petitioner and Telesoft) had competed with the consortium, in violation of the obligations provided for in the consortium's agreements and the articles of association. Nhai consequently asked that Telecom Italia be ordered to pay damages of between 16 million and 25 million for the losses incurred by the consortium and by Help, for its share, in connection with the orders not received.

Nhai also alleged that Telesoft, during the life of CREATT, had appropriated software developed by Help, in violation of the agreements between the members of the consortium, and for this it claimed damages of 1 million.

Telecom Italia is defending the case, arguing that Nhais claims are unfounded and inadmissible.

## **GALACTICA**

The dispute initiated in 2000-2001 by the Internet Service Provider Galactica owing to Telecom Italia's alleged non-performance of an experimental contract for the supply of connectivity and in relation to conduct on the part of Telecom Italia allegedly constituting acts of unfair competition under Article 2598 of the Italian Civil Code is still pending. Galactica's claims for damages amount to more than 90 million.

In the proceedings Telecom Italia has argued that Galactica's claims are unfounded and has filed a counterclaim for Galactica to be ordered to pay more than 5 million as consideration for the increase in traffic in the period January-July 2001.

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**VODAFONE**

In October 2006, Telecom Italia filed an urgent petition with the Rome Court for an injunction on any action aimed at promoting, advertising or marketing, including preselling, the Vodafone Casa Numero Fisso offer. Partially granting Telecom Italia's petition with an order issued on November 29, 2006 the court enjoined Vodafone from any further marketing and preselling of the Vodafone Casa Numero Fisso service involving the offer to users of the portability of their Telecom Italia fixed line number to the Vodafone mobile network. Vodafone has filed an appeal against this order.

Meanwhile, the Ministry of Communications had authorized Vodafone to supply the service on an experimental basis with a decision issued on December 7, 2006. Telecom Italia challenged the authorization and petitioned for a suspension of its execution. In February 2007 the Lazio Administrative Court granted the petition, deeming it necessary to acquire information from the National Regulatory Authority as to whether the service in question could be classified as a fixed-line service and whether Vodafone had a valid authorization and acknowledging that there were sufficient indications of serious and irreparable prejudice at least in a competitive perspective. The Lazio Administrative Court set a time limit for the National Regulatory Authority to produce the above-mentioned information, pending which it suspended the enforceability of the authorization. The discussion regarding the merits of the case is scheduled for May 2007.

For the sake of completeness, on December 29, 2006, the National Regulatory Authority decided to begin a public consultation on integrated services, including Vodafone Casa Numero Fisso.

Since Telecom Italia had suspended negotiations on the inverse interconnection contract underlying the Vodafone Casa Numero Fisso offer, on November 2, 2006. Vodafone brought a civil action before the Milan Court to establish that Telecom Italia had breached its obligation to negotiate the interconnection service and alleging that this refusal constituted unfair competition. Vodafone also petitioned the court to order Telecom Italia to supply the interconnection service immediately and to pay damages in an amount to be determined during the trial. Telecom Italia is defending the case, challenging the regularity of all the initiatives undertaken.

\* \* \*

The appeal Telecom Italia filed with the Supreme Court in December 2005 against the decision of October 2005 with which the State Council reversed the ruling of the Lazio Regional Administrative Court and annulled National Regulatory Authority Resolution 1/CIR/98 (Approval of Telecom Italia's Reference Interconnection Offer) is still pending.

The question originated from a claim with which Omnitel (now Vodafone) challenged the part of Resolution 1/CIR/98 establishing that, pursuant to a ministerial decree issued on April 23, 1998, the new economic conditions for interconnections would become effective for the existing GSM licence-holders (TIM and Omnitel) from July 25, 1998 (the date Telecom Italia's reference offer was submitted) rather than retroactively from January 1, as envisaged for the fixed-network operators.

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In November 2005, following the State Council's decision in favour of Vodafone's claim transmitted an extra-judicial request to Telecom Italia for the restitution of more than 16 million in alleged overpayments for interconnection services supplied between January 1 and July 24, 1998. The sum has not been paid because of the appeal pending before the Supreme Court.

\* \* \*

Proceedings, under Article 33 of Law No. 287/1990, are underway before the Milan Court of Appeal in the action brought by Vodafone against Telecom Italia in July 2006 for damages amounting to approximately 525 million in relation to Telecom Italia's alleged abuse of dominant position consisting of the exploitation of its position in fixed telephony markets to strengthen its position in the contiguous market for mobile communication services with exclusionary effects to the detriment of its competitor.

According to Vodafone, Telecom Italia had abused its dominant position in the fixed telephony market and taken advantage of its market power in the supply of mobile telephony services and the recent restructuring of the

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group with the organizational and functional integration of Telecom Italia and TIM by: (a) exploiting the information it held as the incumbent fixed telephony operator to create client profiles and offer targeted mobile communication services and combined fixed/mobile services; (b) using strategic information regarding fixed telephony to compete in the mobile telephony market with offers that competitors could not replicate; (c) offering discounts for fixed telephony services to take clients away from Vodafone in the mobile telephony market; and (d) using the 187 service to promote mobile communication services.

The conduct in question is alleged to have concerned business as well as retail customers and to have violated the law on the protection of personal data.

During the trial Vodafone produced certain documental evidence of the abusive conduct of which it accuses Telecom Italia and increased its July 2006 claim for damages to 759 million as of December 31, 2006.

Telecom Italia is defending the case, challenging Vodafone's claims.

**IL NUMERO ITALIA**

The action initiated in September 2005 by Il Numero Italia S.r.l. and its subsidiary DA Directory Assistance Company S.r.l. for damages of approximately 92 million for unfair competition in relation to the alleged violation by Telecom Italia of National Regulatory Authority Resolution 15/04/CIR (concerning assignment of the rights to use new numbers of the 12xy series for subscriber information services) is still pending.

Telecom Italia has filed a counterclaim for about 100 million for unfair competition in the form of misleading and denigratory comparative advertising.

**TELE2**

The following actions involving Tele2, are currently pending:

- the action brought by Tele2 in May 2005 requesting an injunction and payment of related damages amounting to approximately 100 million relating to the alleged abuse of dominant position by Telecom Italia consisting in the application to all users, including the customers of other operators, of a discount equal to one hour of local telephone calls for residential and non-residential customers and to half an hour of long-distance calls for residential customers every two months (the offer known as Hello Gratis );

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- the action brought by Tele2 (following an urgent petition upheld in September 2005 with an order subsequently revoked after Telecom Italia had lodged a complaint) requesting an injunction and payment of related damages amounting to approximately 15 million on the alleged abuse of dominant position by Telecom Italia in connection with the wholesale offer of ADSL broadband data access (with special reference to Telecom Italia's application in the E@SY.IP contract of the obligation to buy at least 5 hours of traffic);
- the action brought by Tele2 in December 2005 (subsequent to an urgent petition under Article 700 of the Italian Code of Civil Procedure and Article 33 of Law No. 287/1990) calling for payment by Telecom Italia of damages amounting to more than 18 million deriving from alleged abusive conduct on the broadband access market by Telecom Italia consisting of the non-execution or delayed execution of orders from Tele2 to activate ADSL service for its own customers or in the activation of Telecom Italia's ADSL service for customers who had never requested it, thereby preventing them from using the ADSL service offered by Tele2;
- the action brought by Telecom Italia in March 2005 against Tele2 and Tele2 AB calling for the payment of approximately 200 million of damages in connection with alleged unfair competition by Tele2 in relation to comparative advertising campaigns it had run that were misleading and denigratory of Telecom Italia. Tele2 subsequently filed a counterclaim (for an amount of approximately 100 million) in connection with alleged anticompetitive conduct of Telecom Italia.

### TISCALI

The action regarding so-called shared access brought by Tiscali before the Court of Rome in December 2005 is still pending. The merits of the case are now being examined following the ruling unfavourable to Telecom Italia on the preliminary petition Tiscali made in early in 2005.

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In this court case, Tiscali has requested Telecom Italia's obligation, established in the preliminary petition, to be confirmed and for the Company to be required to pay damages, as quantified during the case, for the loss of revenue caused by the impossibility of providing the ADSL service to retail customers and for the harm done to Tiscali's image and reputation.

Telecom Italia is defending the case. The case dates back to the shared access service supply contract concluded between Telecom Italia and Tiscali on July 27, 2004. The contract called for Tiscali to be supplied unbundled shared access to the connections of Telecom Italia's copper distribution network (with which Telecom Italia continues to supply final customers with voice telephony, while Internet access is provided by another operator, Tiscali in the case in question). According to Tiscali, requests to activate the shared access service for numerous customers met with a refusal by Telecom Italia to free up the lines with which it provides Internet access services (marketed under the trademarks Alice and Tin.it) to final customers, so that Telecom Italia customers who opted to use Tiscali's Internet access services in place of those supplied by Telecom Italia were in fact unable to extricate themselves from Telecom Italia, which was therefore violating both its contractual obligations in respect of Tiscali and the rules laid down by the National Regulatory Authority.

**ALICE 20 MEGA**

In November 2006 the Lazio Regional Administrative Court published its ruling upholding the claim submitted by the Italian Association of Internet Providers to suspend and void the decision of the National Regulatory Authority authorizing Telecom Italia's offer of access to ADSL services up to 20 Mbit/sec (Alice 20 Mega), together with a wholesale offer based on managed IP solutions. According to the claim, the wholesale offer, as configured, did not allow competitors to replicate the offer to final customers. Telecom Italia has appealed the Administrative Court ruling before the Council of State.

In the meantime, however, in a resolution notified to the Company on February 13, 2007, the National Regulatory Authority, while approving the offer of *wholesale flat ADSL with individual access and downstream access speeds up to 20 Mbit/sec using Ethernet IP technology* (presented in December 2006 and characterized by technical access parameters corresponding to those of the retail Alice 20 Mega service), authorized the marketing of Alice 20 Mega again. The National Regulatory Authority considered that the marketing of wholesale ADSL offers that meet the requirements of replicability made the overall offer consistent with the ruling of the Lazio Regional Administrative Court.

**PRESUMED VIOLATIONS OF ANTITRUST LAW (CASE A-285)**

In a judgment handed down on January 10, 2007, the Council of State partially upheld the cross appeal by the National Regulatory Authority against the decision of the Lazio Regional Administrative Court concerning fine no. 9472 imposed by the Antitrust Authority on April 27, 2001 at the end of case A-285 for Telecom Italia's abuse of dominant position in the supply of ADSL services. The fine was equal to 59.4 million which the Administrative Court's judgment reduced to about 29.4 million, which the Company paid under protest in January 2002. The Council of State subsequently increased the fine to approximately 31.7 million. The financial statements for the year ended December 31, 2006 include the residual amount payable of approximately 2.5 million.

\* \* \*

**ANTITRUST PROCEEDING A-357**

On February 23, 2005, the Antitrust Authority initiated an investigation of Tim Italia S.p.A. and Telecom Italia Mobile S.p.A. (now part of Telecom Italia), Vodafone Omnitel N.V. and Wind Telecomunicazioni S.p.A. to establish whether violations of Articles 81 and 82 of the European Community Treaty had been committed in relation to:

- refusal to grant alternative operators (MVNO, ESP and ATR) access to the mobile network;
- the offer to final business customers of integrated fixed/mobile telephony services at prices below the price of the termination service alone (offered to competitors as an intermediate factor);
- the offer exclusively to business customers of a technical solution (MSC PABX) permitting them to obtain more advantageous integrated fixed/mobile tariffs;
- the marketing practices adopted by TIM in relation to business customers.

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The time limit for completion of the investigation, initially scheduled for December 14, 2006, has been extended to May 10, 2007. If the investigation should find one or more violations, the Antitrust Authority could impose a fine whose size would depend on their seriousness and duration.

**ACTIONS UNDER ARTICLE 33 OF LAW No. 287/1990 CONCERNING THE MARKETING OF X-DSL SERVICES**

After the completion of the above-mentioned antitrust proceeding no. A-285 with an unfavourable ruling for Telecom Italia and the imposition of a fine, between 2001 and 2005 a number of companies brought actions for damages against the Company in relation to its alleged abuse of dominant position in the supply of X-DSL services.

The companies in question were Wind Telecomunicazioni, I.Net S.p.A., Cybernet Italia S.p.A., KPNQwest and ITnet S.p.A. In 2001, the proceedings were unified and the total damages claimed amounted to approximately 120 million.

In the past, other operators (including Infostrada, Albacom and the Italian Internet Provider Association) had brought similar claims and in 2003 Telecom Italia was ordered to pay damages of approximately 2 million (compared with alleged damages of more than 87.5 million).

Telecom Italia therefore reasonably believes, if the court remains faithful to the earlier ruling, that the damages awarded are likely to be much less than those claimed by the plaintiffs and Telecom Italia has accordingly created an appropriate provision for risks and charges.

**SOCIAL SECURITY CONTRIBUTION RELIEFS GRANTED TO TIM S.p.A.**

In a letter dated February 13, 2007, the National Social Security Institution (INPS) requested Telecom Italia to refund the social security contribution relief received by TIM between 1995 and 2001 in connection with the hiring of workers pursuant to on-the-job training contracts. According to INPS, relief granted under Italian law, constituted, on the basis of the criteria recently specified by the European Union, state aid that was incompatible with the standards of free competition of the European common market. INPS requested the Company to refund a total of 9.6 million, including accrued interest.

The analyses that the Company has carried out so far have not revealed any facts indicating that the above-mentioned relief was irregular.

**LEVY PURSUANT TO ARTICLE 20.2 OF LAW No. 448/1948**

In a ruling published on July 10, 2006, the Lazio Administrative Court upheld the compliance petition submitted by Telecom Italia and ordered the Ministry for the Economy and Finance and the Ministry for Communications, jointly and severally, to implement the decisions published in January 2005, in which the administrative court had upheld the appeals filed by TIM and Telecom Italia and ascertained the obligation for the government to return the amounts paid as a levy for 1999 under Article 20.2 of Law No. 448/1998 and the related interest accrued in the meantime (respectively 546 million and over 100 million).

In September 2006, on behalf of the above referenced Ministries, the Avvocatura Generale dello Stato notified an appeal to the Council of State for the suspension of the enforceability and annulment of the administrative court's ruling. On November 7, 2006, the Council of State dismissed the request for a suspension and consequently the Ministry for the Economy and Finance paid the principal amount but not the interest, with the right to its restoration depending on the outcome of the appeal.

#### **CECCHI GORI**

In relation to the complex set of legal disputes initiated by the Cecchi Gori Group against SEAT (now Telecom Italia Media) and, in particular, the action related to the resolutions adopted on April 27, 2001 by the shareholders' meetings of Cecchi Gori Communications (now Holding Media Communications) approving the annual report and financial statements for the year ended December 31, 2000 and the cancellation and subsequent reconstitution of the company's share capital, in November 2005 the Rome Court of Appeal dismissed the Cecchi Gori group's appeal against the ruling of the Rome Court of first instance to reject the petition for annulment of the resolutions. The Rome Court of Appeal's ruling has been challenged before the Supreme Court.

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In addition, in a ruling issued in December 2006, the Rome Court of Appeal dismissed the action brought by the Cecchi Gori Group against the ruling of the court of first instance dismissing the request to declare null and void the resolution of the extraordinary shareholders meeting of Cecchi Gori Communications of August 11, 2000 concerning amendments to the company's bylaws. The Cecchi Gori Group has challenged the Rome Court of Appeal's ruling before the Supreme Court.

In March 2006, the Milan Court of Appeal dismissed the appeal by the Cecchi Gori Group against the ruling issued by the court of first instance rejecting the petition for annulment or cancellation of the act pledging the Cecchi Gori Communications shares owned by Cecchi Gori Media Holding. This ruling has also been challenged before the Supreme Court.

The following claim is still pending before the Court of Milan: an action for damages for illicit extracontractual conduct by the Cecchi Gori Group in relation to the presumed adverse effect caused by the alleged conduct of SEAT and by the directors it appointed to the board of Cecchi Gori Communications aimed at the removal of the majority shareholder Cecchi Gori Media Holding. The case is currently suspended pending the rulings of the Supreme Court on the other disputes.

**BRAZIL**

As reported in last year's Annual Report, on April 28, 2005 we agreed:

- to settle a series of disputes in different venues involving Telecom Italia and Telecom Italia International against respectively: (i) Brasil Telecom, for alleged abuses by the Group in extraordinary corporate actions undertaken by the Brazilian operator; and (ii) Telecom Italia International's partners in Solpart Participações (controlling Brasil Telecom through Brasil Telecom Participações) and Solpart, Brasil Telecom Participações and Brasil Telecom in connection with the agreement concluded on August 27, 2002 for the temporary reduction from 37.29% to 19% of the Group's interest in the ordinary capital of Solpart and the reduction again temporary of its governance rights, with an option for the repurchase of the aforesaid equity interest;
- to amend the shareholders' agreement among the shareholders of Solpart (Telecom Italia International, Techold and Timepart);
- to draw up a plan for the merger of Brasil Telecom Celular into Tim Brasil.

Reference was also made in last year's Annual Report to the beginning of several disputes regarding the above-mentioned agreements in which the Telecom Italia Group was sometimes the plaintiff and sometimes the defendant, with reciprocal requests for damages, both before the Brazilian courts and in arbitration proceedings before the International Chamber of Commerce of Paris. These disputes are ongoing.

Other developments include:

- the definitive dismissal of the requests put forward by the association of small shareholders of the listed Brazilian telecommunications companies (ANIMEC) to reconsider the decision of the Brazilian Antitrust Authority (CADE) recognizing the right of Telecom Italia International to be readmitted to the group controlling Solpart (with some restrictions), with the consequent right to appoint the independent members of the Boards of Directors of Solpart, Brasil Telecom Participações and Brasil Telecom;
- following the termination of the agreement for the merger of Brasil Telecom Celular into Tim Brasil, application has been made for the closure of the related proceedings since the disputed matter no longer exists. In one of the two proceedings the judge has upheld the request, while in the second the judge has asked the parties whether they intend to settle the dispute.

## **CUBA**

Since 2002, Banco Nacional de Comercio Exterior ( Bancomext ) has accused ETECSA and Telcel (majority shareholder of ETECSA, controlled by the Cuban government) of non-performance of alleged payment and guarantee obligations amounting to U.S.\$300 million established in a series of contracts between ETECSA, Telcel, BanCuba (Central Bank of Cuba), Intesa BCI and Bancomext.



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These accusations were the subject (i) of an action brought by Bancomext in Italy before the Turin court and (ii) of an international arbitration proceeding initiated by Telan and ETECSA, in which they pleaded that performance was impossible owing to a Cuban legislative measure prohibiting actions aimed at satisfying Bancomext's claim.

In the award issued on August 5, 2004, the arbitration board:

- upheld ETECSA's argument that it was neither a debtor of Bancomext nor a guarantor of Telan;
- nonetheless determined that ETECSA was contractually required to satisfy the obligations towards Bancomext deriving from the loan agreement and therefore to restore the procedure envisaged for the payment of dividends belonging to Telan with a view to satisfying Bancomext.

This decision would oblige ETECSA to transfer around U.S.\$147 million to Telan, paying the sum into an escrow account in Bancomext's name.

On May 3, 2005, Bancomext therefore notified ETECSA and Telan of the award, together with a request for payment of an amount equal to the dividends distributed to Telan from April 2002. The related enforcement proceedings, initially undertaken by Bancomext against Telecom Italia, TI Sparkle and TIM following the declaration of the award's effectiveness in Italy, were subsequently suspended.

In November 2005, at the conclusion of the first-degree trial initiated by Bancomext before the Italian courts, the Court of Turin ordered ETECSA to pay Bancomext damages of U.S.\$168 million and to restore the mechanism for the payment of dividends belonging to Telan, as contractually provided.

Following the publication of the decision of the Court of Turin (which ETECSA nonetheless appealed), in December 2005 Bancomext applied to the Court of Milan (i) to convert the precautionary sequestration of the Company's claims on ETECSA, which the Court of Turin had ordered in 2002 as a precautionary measure, into seizure and (ii) to assign Bancomext the sum of 2.8 million due to Telecom Italia, which was therefore paid to Bancomext in September 2006.

In October 2006, at Bancomext's request, the High Court of Justice-Queen's Bench Division in London enforced the judgment of the Turin Court referred to above by issuing an attachment order covering all ETECSA's assets and claims in England and Wales up to GBP 100 million. ETECSA was also enjoined not to dispose of any other assets or claims, wherever located, up to the same amount.

Lastly, in November 2006 the Paris Court of Appeal upheld ETECSA's request to declare the above-mentioned arbitration award null and void. Accordingly, ETECSA applied to the Turin Court of Appeal for the revocation of the provisional enforceability of the judgment of the Court of Turin.

**GREECE**

On January 23, 2007, Telecom Italia, among others, received notice of a claim by TCS Capital Management LLC (TCS) before the United States District Court for the Southern District of New York.

TCS (previously a minority shareholder of Tim Hellas) claimed an indemnity for the losses it allegedly incurred following the sale of Tim International's interest in Tim Hellas to certain investment funds (which are also called to respond) and the subsequent cash-out merger carried out by the funds, allegedly to the detriment of the interests of the minority shareholders of Tim Hellas.

TCS has requested the court to ascertain Telecom Italia's violation of U.S. law, which is applicable because Tim Hellas is listed on NASDAQ and to order it to pay punitive damages and legal expenses in an amount to be established during the trial.

**OTHER LIABILITIES RELATED TO THE DISPOSAL OF ASSETS AND EQUITY INTERESTS**

As part of the major disposals of assets and companies in 2006 and in prior years, the Telecom Italia Group undertook to indemnify the buyers in the event of the companies incurring certain liabilities, normally up to a

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percentage of the purchase price. The amounts in question mainly refer to contingent liabilities arising from guarantees contained in the contracts and disputes in the legal, tax, social security and labour law fields.

The financial statements for the year ended December 31, 2006 report 200 million of provisions charged in respect of these potential obligations. The additional guarantees related to the above-mentioned disposals, which are considered to represent a remote risk, amounted to approximately 700 million.

The Telecom Italia Group also undertook to indemnify buyers in other cases for which no maximum amount was fixed, so that it is not possible to estimate the amount that the Company might be requested to pay.

**b) Contingent assets**

**APPEAL AGAINST PAYMENT OF LICENCE FEES FOR 1998**

With reference to the appeals submitted by Telecom Italia and TIM regarding their right to the restitution of the licence fees they paid for 1998 ( 386 million for Telecom Italia and 143 million for TIM plus interest), in May 2006 the Lazio Administrative Court applied to the European Court of Justice for a ruling on the compatibility with Community law of Article 20 of Law No. 488/1998, which, in an already liberalized market, had extended the obligation to pay the licence fee to 1998. The Italian court considered this provision to be potentially in conflict with Directive 97/13 and therefore to fall within the scope of the European Court's decision on the illegitimacy of the levy provided for in Article 20.2 of Law No. 448/1998, as referred to above.

**CONSIP AUCTION**

In May 2006, Fastweb was awarded the contract in the auction held by Consip in 2005 for fixed telephony, IP connectivity and satellite data transmission services for governmental bodies.

With an appeal filed with the Lazio Administrative Court on July 6, 2006 Telecom Italia applied for the suspension and annulment of the award because of evident anomalies in the economic conditions of Fastweb's bid. It also applied for the annulment of the Consip letters in which the application for access to the auction documentation was only partially granted. In fact Fastweb had requested that access be denied to all the tender documentation or at least to the percentage division between local loop unbundling and carrier pre-selection services and the list showing the geographical distribution and date of takeover of unbundled lines. In examining the application for the suspension of the award, the court upheld the petition for access to the auction documentation filed by Fastweb.

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On the basis of the documentation subsequently acquired, Telecom Italia filed a document with additional grounds for opposing the acts of the auction committee.

On November 13, 2006 the court ordered a technical appraisal of the overall reliability of the assessment of non-abnormality put forward by the auction committee against Fastweb. The technical appraisal began in December 2006 and was completed with the filing of the related report on March 28, 2007.

### **H3G**

In July 2006, Telecom Italia notified H3G Italia of the beginning of an arbitration proceeding on the basis of the arbitration clause contained in the agreements concluded between the parties in February 2004 and subsequently supplemented in May 2005. These agreements govern, among other things, the prices for mobile network termination on a reciprocal basis.

The dispute has its origin in H3G's position regarding the contractual amounts payable, which it claims have been modified in its favour by the evolution of the regulatory framework.

Consequently, Telecom Italia has called for verification, through arbitration, of H3G's failure to fulfill its contractual obligations and the determination of the amount of the losses H3G must make good.

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**ACTIONS BROUGHT AGAINST OTHER OPERATORS FOR UNFAIR COMPETITION AND VIOLATION OF PRIVACY**

In October 2006, Telecom Italia submitted an urgent petition to the Rome court, accusing Fastweb, Wind and Tele2 of unfair competition. In particular, it applied for the court to declare that the three companies' telemarketing policies violated competition rules because they were based on indiscriminate telephone calls to Telecom Italia's customers, including some whose numbers were not listed and others who had not consented to such contacts (and who therefore should not have been contactable for telephone promotions).

Despite recognizing the legal validity of Telecom Italia's arguments as a matter of law, in December 2006, the court dismissed the claim on the grounds that it failed to adequately prove that Telecom Italia's competitors had actually used Telecom Italia's customers personal data without their prior consent. In January 2007, Telecom Italia submitted an appeal against the court's order accompanied by the evidence whose absence had led to the dismissal of the petition by the lower court.

The circumstances that led to the above-mentioned petition have also been reported to the Privacy Regulator.

\* \* \*

**EMPLOYEE BENEFIT OBLIGATIONS UNDER LAW No. 58/1992**

Pursuant to Law No. 58/1992 Telecom Italia is required to provide full national insurance coverage for all the employees of Stet, Sip, Italcable and Telespazio as of February 20, 1992 as well as for all employees transferred from the public administration to the former Iritel through the Telephone Companies Employees Social Security Fund, which on January 1, 2000 became part of the general Employees Pension Fund.

At the present time, the amount of the liability can be estimated only roughly due to disagreements with the National Social Security Institute (INPS) regarding the calculation of the amounts due and the fact that at December 31, 2006 INPS had not yet notified the Company of all the positions to be covered.

The dispute with INPS concerns the application of the criteria established by Law No. 29/1979 for those employees (except for those of the former Iritel) who had already applied for benefits pursuant to this law and which had not been processed by INPS. The parties have agreed that the differences in interpretation shall be settled through test appeals before the ordinary magistrate, with recourse to the Court of Appeals being waived for a final determination of the law in question. While proceedings are pending, Telecom Italia has agreed to pay, with reservation, the amounts requested by INPS, subject to subsequent equalization adjustments if the Courts ultimately accept the Company's interpretation. The amounts due were calculated by INPS and are to be paid in 15 equal annual deferred installments (including annual interest of 5%), starting when INPS formally submits its requests.

The principal amount of the liability attributable to Telecom Italia as of December 31, 2006 was 924 million recorded under Payables to social security authorities item ( 881 million as principal amount and 43 million as accrued interest, not yet paid), including 215 million due in the short-term.

**c) Commitments and other guarantees**

Guarantees provided amounted to 330 million, net of 180 million of counter-guarantees received, and consisted mainly of sureties provided by Telecom Italia on behalf of associates ( 102 million) and others for medium and long-term loans.

In addition, the 47.80% interest in Tiglio I and the 49.47% interest in Tiglio II have been pledged to the banks that financed the two associates.

Purchase and sale commitments at December 31, 2006 amounted to 455 million and 2 million, respectively, and referred to the part of commitments not falling within the normal operating cycle of the Group still to be fulfilled.

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The purchase commitments consisted mainly of:

164 million of property leasing rentals under contracts lasting more than 6 years;

242 million of orders to suppliers of Telenergia in relation to the electricity supply agreements reached with Endesa;

17 million for the purchase by Telecom Italia Media Broadcasting of radio and television equipment in Sicily.

Companies included in the scope of the consolidation issued letters of patronage for a total of 141 million, chiefly on behalf of associates to guarantee insurance policies, lines of credit and overdraft arrangements.

Guarantees provided by third parties for obligations of Group companies referred to loans ( 1,934 million) and the performance of contracts ( 295 million). The total included sureties issued by BBVA for 817 million, by Sanpaolo IMI for 420 million, by Sumitomo for 73 million, Bank of Tokyo Mitsubishi UFJ for 86 million, and Banco Santander for 86 million in respect of EIB loans for the following projects: Tim Mobile Network, Telecom Italia Breitband Infrastruktur Deutschland and Telecom Italia Media Digital Network.

**NOTE 27 REVENUES**

**Revenues** amount to 31,275 million in 2006, 29,919 million in 2005 and 28,292 million in 2004, showing an increase of 1,356 million in 2006 compared to 2005 (or 4.5%) and an increase of 1,627 million in 2005 compared to 2004 (or 5.7%).

Details of revenues are as follows:

|                      | Year ended December 31, |              |              |
|----------------------|-------------------------|--------------|--------------|
|                      | 2006                    | 2005         | 2004         |
|                      | (millions of Euro)      |              |              |
| <b>Sales:</b>        |                         |              |              |
| • telephone products | 2,002                   | 1,952        | 1,595        |
| • other sales        | 388                     | 362          | 584          |
|                      | <b>(A) 2,390</b>        | <b>2,314</b> | <b>2,179</b> |
| <b>Services:</b>     |                         |              |              |
| • traffic            | 16,607                  | 15,810       | 14,960       |

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|  |         |        |        |
|--|---------|--------|--------|
| • subscription charges                                 | 8,111   | 8,133  | 7,837  |
| • fees   | 400     | 359    | 327    |
| • Value Added Services (VAS) mobile telecommunications | 1,967   | 1,641  | 1,314  |
| • fixed fee for recharging prepaid cards               | 738     | 737    | 617    |
| • other services                                       | 1,022   | 850    | 882    |
|  | (B)     | 28,845 | 27,530 |
| <b>Revenues on construction contracts</b>              | (C)     | 40     | 75     |
| <b>Total</b>   | (A+B+C) | 31,275 | 29,919 |
|  |         | 28,292 |        |

Revenues from telecommunications services are presented gross of amounts due to other TLC operators, equal to 5,721 million in 2006, (up 18.5%), 4,829 million in 2005 (up 13.9%) and 4,241 million in 2004.

In 2006, the increase in the amount due to other TLC operators of 892 million reflects the positive impact of 262 million deriving from changes in operations and regulations regarding the interconnection relationships among the mobile telephone operators in the Brazilian market starting from July 2006 (similarly, there was an increase in costs for the portion to be paid to other TLC operators).

In 2005, the increase of 588 million is mainly a result of the increase of revenues.

For a breakdown of revenues by business/geographical segment, reference should be made to Note 40-Segment information .



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**Other income** amounted to 606 million in 2006, 678 million in 2005 and 1,099 million in 2004, showing a decrease of 72 million in 2006 compared to 2005 and a decrease of 421 million in 2005 compared to 2004.

Details of other income are as follows:

|   | Year ended December 31, |            |              |
|---|-------------------------|------------|--------------|
|   | 2006                    | 2005       | 2004         |
|   | (millions of Euro)      |            |              |
| Compensation for late payment of regulated telephone services | 91                      | 105        | 85           |
| Release of provisions and other liabilities                   | 179                     | 228        | 162          |
| Recovery of costs of personnel and services rendered          | 60                      | 56         | 35           |
| Capital grants and grants related to income                   | 42                      | 47         | 64           |
| Damage compensations and penalties                            | 52                      | 35         | 32           |
| Income from release of prior TLC operating fee                |                         |            | 546          |
| Other income  | 182                     | 207        | 175          |
| <b>Total</b>  | <b>606</b>              | <b>678</b> | <b>1,099</b> |

**NOTE 29 PURCHASES OF MATERIALS AND EXTERNAL SERVICES**

**Purchases of materials and external services** amounted to 14,191 million in 2006, 12,937 million in 2005 and 11,812 million in 2004, showing an increase of 1,254 million in 2006 (or 9.7%) compared to 2005 and an increase of 1,125 million in 2005 (or 9.5%) compared to 2004.

Details are as follows:

|  | Year ended December 31, |              |              |
|--|-------------------------|--------------|--------------|
|  | 2006                    | 2005         | 2004         |
|  | (millions of Euro)      |              |              |
| <b>Purchases of materials and merchandise for resale</b> | <b>(A) 2,578</b>        | <b>2,506</b> | <b>2,203</b> |

|   |                |               |               |
|---|----------------|---------------|---------------|
| <b>Costs of services:</b>   |                |               |               |
| Revenues due to other TLC operators   | 5,721          | 4,829         | 4,241         |
| Commissions, sales commissions and other selling expenses                                       | 1,511          | 1,263         | 1,006         |
| Advertising and promotion expenses  | 584            | 593           | 504           |
| Professional consulting and services  | 480            | 530           | 608           |
| Utilities   | 421            | 308           | 244           |
| Maintenance   | 350            | 339           | 395           |
| Outsourcing costs for other services  | 267            | 256           | 244           |
| Mailing and delivery expenses for telephone bills, directories and other materials to customers | 106            | 90            | 64            |
| Other service expenses  | 1,130          | 1,119         | 1,355         |
|   | <b>(B)</b>     | <b>10,570</b> | <b>9,327</b>  |
| <b>Lease and rental costs:</b>  |                |               |               |
| Property lease rents  | 560            | 641           | 624           |
| TLC circuit lease rents and rents for use of satellite systems                                  | 271            | 274           | 154           |
| Other lease and rental costs  | 212            | 189           | 170           |
|   | <b>(C)</b>     | <b>1,043</b>  | <b>1,104</b>  |
| <b>Total</b>  | <b>(A+B+C)</b> | <b>14,191</b> | <b>12,937</b> |
|   |                | <b>11,812</b> |               |

**NOTE 30 PERSONNEL COSTS**

**Personnel costs** amount to 3,801 million in 2006, 4,142 million in 2005 and 3,852 million in 2004, showing a decrease of 341 million in 2006 (or 8.2%) compared to 2005 and an increase of 290 million in 2005 (or 7.5%) compared to 2004.

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Personnel costs (which include, among others, costs relating to defined contribution plans) consist of the following:

|  | Year ended December 31, |              |              |
|--|-------------------------|--------------|--------------|
|  | 2006                    | 2005         | 2004         |
| (millions of Euro)   |                         |              |              |
| <b>Personnel costs at payroll:</b>   |                         |              |              |
| Wages and salaries   | 2,625                   | 2,600        | 2,595        |
| Social security contributions  | 796                     | 813          | 812          |
| Employee severance indemnities   | 146                     | 168          | 183          |
| Other employee-related costs   | 71                      | 88           | 64           |
|  | <b>(A)</b>              | <b>3,638</b> | <b>3,669</b> |
|  |                         | <b>55</b>    | <b>52</b>    |
| <b>Temp work costs</b>   | <b>(B)</b>              | <b>55</b>    | <b>38</b>    |
| <b>Miscellaneous expenses for personnel and for other labor-related services rendered:</b> |                         |              |              |
| Remuneration of personnel other than employees   | 18                      | 18           | 17           |
| Charges for termination benefit incentive plans  | 76                      | 394          | 143          |
| Other  | 14                      | 9            |              |
|  | <b>(C)</b>              | <b>108</b>   | <b>421</b>   |
| <b>Total</b>   | <b>(A+B+C)</b>          | <b>3,801</b> | <b>4,142</b> |
|  |                         | <b>3,852</b> | <b>3,852</b> |

In 2006, the decrease of 341 million is principally due to a reduction in accruals and expenses recorded in 2005 for employee termination benefit incentive plans and, to a lesser extent, the reduction of personnel costs at payroll and temp work costs which fell by 28 million (-0.8%).

The decrease in the charge for employee severance indemnities is due to the effect of the actuarial calculation of the provision for employee severance indemnities and the turnover of personnel working at the Italian companies of the Group.

Other employee-related costs in 2006 include 1 million for the valuation of stock options and 22 million for other benefits to employees.

In 2005, the increase of 290 million was principally due to charges for termination benefit incentive plans, which increased by 251 million; excluding these charges personnel costs would have increased by 1.0%.

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The decrease in the charge for employee severance indemnities is due to the effect of the actuarial calculation of the provision for employee severance indemnities and the turnover of personnel working at the Italian companies of the Group.

Other employee-related costs in 2005 included 4 million for the valuation of stock options and 81 million for other benefits to employees.

The average equivalent number of salaried personnel, excluding those of discontinued operations/assets held for sale and including personnel with temp work contracts, is 79,993 in 2006, 79,869 in 2005 and 79,602 in 2004. A breakdown by category is as follows:

|   | Year ended December 31, |               |               |
|---|-------------------------|---------------|---------------|
|   | 2006                    | 2005          | 2004          |
|   |                         | (units)       |               |
| Executives                                | 1,384                   | 1,541         | 1,592         |
| Middle management                         | 5,065                   | 4,744         | 4,597         |
| White collars                             | 70,748                  | 70,375        | 70,540        |
| Blue collars                              | 417                     | 722           | 920           |
| <b>Total employees at payroll</b>         | <b>77,614</b>           | <b>77,382</b> | <b>77,649</b> |
| <b>Personnel with temp work contracts</b> | <b>2,379</b>            | <b>2,487</b>  | <b>1,953</b>  |
| <b>Total employees</b>                    | <b>79,993</b>           | <b>79,869</b> | <b>79,602</b> |

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At December 31, 2006, the number of employees, excluding those relating to discontinued operations/assets held for sale is 83,209 (85,484 at December 31, 2005) with a decrease of 2,275.

Employees by segment are analyzed in Note 40-Segment information .

**NOTE 31 OTHER OPERATING EXPENSES**

**Other operating expenses** amount to 1,543 million in 2006, 1,468 million in 2005 and 1,603 million in 2004, showing an increase of 75 million in 2006 (or 5.1%) compared to 2005 and a decrease of 135 million in 2005 (or 8.4%) compared to 2004.

Details are as follows:

|   | Year ended December 31, |              |              |
|---|-------------------------|--------------|--------------|
|   | 2006                    | 2005         | 2004         |
|   | (millions of Euro)      |              |              |
| Impairments and charges for bad debts         | 564                     | 521          | 498          |
| Provision for risks and charges               | 107                     | 71           | 289          |
| TLC operating fees                            | 236                     | 181          | 114          |
| Taxes on revenues of South American companies | 222                     | 178          | 112          |
| Duties and indirect taxes                     | 156                     | 141          | 153          |
| Association fees and dues                     | 16                      | 19           | 18           |
| Other expenses                                | 242                     | 357          | 419          |
| <b>Total</b>                                  | <b>1,543</b>            | <b>1,468</b> | <b>1,603</b> |

**NOTE 32 CAPITALIZED INTERNAL COSTRUCTION COSTS**

**Capitalized internal construction costs** amount to 496 million in 2006, 471 million in 2005 and 713 million in 2004, showing an increase of 25 million in 2006 (or 5.3%) compared to 2005 and a decrease of 242 million in 2005 (or 33.9%) compared to 2004.

Capitalized internal construction costs consist of the following:

|  | Year ended December 31, |            |            |
|--|-------------------------|------------|------------|
|  | 2006                    | 2005       | 2004       |
|  | (millions of Euro)      |            |            |
| <b>Capitalized internal construction costs on:</b> |                         |            |            |
| • Intangible assets with a finite life             | 318                     | 287        | 522        |
| • Property, plant and equipment owned              | 178                     | 184        | 191        |
| <b>Total</b>                                       | <b>496</b>              | <b>471</b> | <b>713</b> |

**NOTE 33 DEPRECIATION AND AMORTIZATION**

**Depreciation and amortization** amount to 5,487 million in 2006, 5,232 million in 2005 and 4,808 million in 2004, showing an increase of 255 million in 2006 (or 4.9%) compared to 2005 and an increase of 424 million in 2005 (or 8.8%) compared to 2004.

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Details of depreciation and amortization are as follows:

|  | Year ended December 31, |              |              |
|--|-------------------------|--------------|--------------|
|  | 2006                    | 2005         | 2004         |
| (millions of Euro)   |                         |              |              |
| <b>Amortization of intangible assets with a finite life:</b>     |                         |              |              |
| Industrial patents and intellectual property rights              | 1,760                   | 1,414        | 1,106        |
| Concessions, licenses, trademarks and similar rights             | 310                     | 253          | 224          |
| Other intangible assets  | 110                     | 17           | 16           |
|  | <b>(A)</b>              | <b>1,684</b> | <b>1,346</b> |
| <b>Depreciation of tangible assets owned:</b>                    |                         |              |              |
| Civil and industrial buildings                                   | 48                      | 103          | 103          |
| Plant and equipment  | 2,644                   | 2,910        | 2,869        |
| Manufacturing and distribution equipments                        | 33                      | 31           | 27           |
| Aircrafts and ships  | 7                       | 9            | 12           |
| Other assets   | 446                     | 363          | 313          |
|  | <b>(B)</b>              | <b>3,416</b> | <b>3,324</b> |
| <b>Depreciation of tangible assets held under finance lease:</b> |                         |              |              |
| Civil and industrial buildings                                   | 99                      | 93           | 93           |
| Plant and equipment  | 1                       | 1            | 1            |
| Aircrafts and ships  | 4                       | 4            | 4            |
| Other assets   | 25                      | 34           | 41           |
|  | <b>(C)</b>              | <b>132</b>   | <b>138</b>   |
| <b>Total</b>   | <b>(A+B+C)</b>          | <b>5,232</b> | <b>4,808</b> |

An analysis of depreciation and amortization by segment is presented in the Note 40-Segment information .

In 2006 the **amortization of intangible assets with a finite life** increased by 496 million, partly due to higher capital expenditures for the development of systems and new services as well as the effect of the change in the exchange rates of the Brazilian companies in the Mobile Business Unit.

The **depreciation of tangible assets (owned and held in leasing)** decreased in 2006 by 241 million. The decrease is due to the effects of the revision in 2006 of the depreciation rates of fixed and mobile network assets which was partially offset by increases due to higher capital expenditures for the development of infrastructures for the network and as support to the business as well as foreign exchange rate effects of the Brazilian companies in the Mobile Business Unit.

This revision of useful lives mainly related to the power supply systems and air-conditioning systems, whose estimated useful life was changed from 8 to 10 years, and transmission installations, whose estimated life went from 7 to 8 years for the mobile network and from 7 to 9 years for the fixed network. This led to a reduction in the depreciation charge for 2006 of 319 million.

In 2005, the increase in **Depreciation and amortization** of 424 million was in part due to the higher levels of amortizable assets (in particular Industrial patents and intellectual property rights) also as a result of the higher investments made in 2004 and 2005.

**NOTE 34 GAINS (LOSSES) ON DISPOSALS OF NON-CURRENT ASSETS**

**Gains (losses) on disposals of non-current assets** amount to a gain of 95 million in 2006, a gain of 242 million in 2005 and a loss of 9 million in 2004, showing a decrease of 147 million in 2006 (or 60.7%) and an increase of 251 million in 2005.



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Details of gains (losses) on disposals of non-current assets are as follows:

|   | Year ended December 31, |            |            |
|---|-------------------------|------------|------------|
|   | 2006                    | 2005       | 2004       |
|   | (millions of Euro)      |            |            |
| <b>Gains realized on the disposal of non-current assets:</b>        |                         |            |            |
| Gains on the retirement/disposal of intangible and tangible assets  | 165                     | 283        | 17         |
| Gains on the disposal of business segments                          |                         |            | 6          |
| Gains on the disposal of investments in consolidated subsidiaries   | 27                      |            | 4          |
|   | <b>(A)</b>              | <b>192</b> | <b>283</b> |
| <b>Losses incurred on the disposal of non-current assets:</b>       |                         |            |            |
| Losses on the retirement/disposal of intangible and tangible assets | 54                      | 40         | 27         |
| Losses on the disposal of business segments                         | 9                       |            |            |
| Losses on the disposal of investments in consolidated subsidiaries  | 34                      | 1          | 9          |
|   | <b>(B)</b>              | <b>97</b>  | <b>41</b>  |
| <b>Total gains (losses), net</b>                                    | <b>(A-B)</b>            | <b>95</b>  | <b>242</b> |
|   |                         | <b>(9)</b> |            |

In 2006, **capital gains of 95 million on non-current assets**, mainly include:

- 135 million for gains, net of transaction charges, relating to the additional sales of properties by the Group in 2006 to the closed-end real estate investment funds Raissa and Spazio Industriale under the program for the sale of properties approved by the Board of Directors meeting held on December 21, 2005;
- 27 million for the gain on the sale of the entire real estate investment held in Ruf Gestion;
- 33 million for the loss on the sale of the entire investment in Telecom Italia Learning Services;
- 9 million for the loss on the sale of the Radiomaritime Activities business and the net capital loss of 25 million on the sale of other non-current assets.

In 2005, **capital gains (losses) on non-current assets** include 264 million for the gain, net of incidental charges, realized on the contribution of 561 properties to the Fondo Raissa and 246 properties to the Fondo Spazio Industriale under the plan which calls for the sale of more than 1,300 properties for a total amount of about 1 billion. Additional details are disclosed in Note 7-Tangible assets (owned and under finance leases) .

**NOTE 35 IMPAIRMENT REVERSALS (LOSSES) ON NON-CURRENT ASSETS**

The **impairment losses, net**, amount to 21 million in 2006, 28 million in 2005 and 444 million in 2004, showing a decrease of 7 millions in 2006 (or 25%) compared to 2005 and a decrease of 416 million in 2005 compared to 2004.

Details are as follows:

|  | Year ended December 31, |             |              |
|--|-------------------------|-------------|--------------|
|  | 2006                    | 2005        | 2004         |
|  | (millions of Euro)      |             |              |
| <b>Impairment reversals on non-current assets:</b> |                         |             |              |
| Impairment reversals on intangible assets          |                         | 1           |              |
| Impairment reversals on tangible assets            |                         |             | 10           |
|  | <b>(A)</b>              | <b>1</b>    | <b>10</b>    |
| <b>Impairment losses on non-current assets:</b>    |                         |             |              |
| Impairment losses on goodwill                      |                         | 6           | 299          |
| Other impairment losses on intangible assets       | 15                      | 11          | 73           |
| Other impairment losses on tangible assets         | 6                       | 12          | 82           |
|  | <b>(B)</b>              | <b>29</b>   | <b>454</b>   |
| <b>Total</b>                                       | <b>(A-B)</b>            | <b>(28)</b> | <b>(444)</b> |

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In 2006, the impairment losses of non-current assets total 21 million and mainly refer to the Latin American Nautilus group following a revision of the prospects for the South American wholesale market.

In 2005, the impairment losses, net, totaled 28 million, of which 6 million was for the impairment of the goodwill relating to the Olivetti cash-generating unit and 10 million for the write-downs made by the companies of the Brazil Mobile Business Unit.

In 2004, the impairment losses, net, totaled 444 million and included 282 million related to the De Agostini transaction for the purchase of 40% of Finanziaria Web, as well as provisions and impairment losses on intangible and tangible assets ( 162 million).

**NOTE 36 FINANCIAL INCOME**

**Financial income** amounts to 3,041 million in 2006, 3,144 million in 2005 and 2,224 million in 2004, showing a decrease of 103 million in 2006 (or 3.3%) compared to 2005 and an increase of 920 million in 2005 (or 41.4%) compared to 2004.

Details are as follows:

|  | Year ended December 31, |              |              |
|--|-------------------------|--------------|--------------|
|  | 2006                    | 2005         | 2004         |
|  | (millions of Euro)      |              |              |
| <b>Income from investments</b>   | <b>(A) 240</b>          | <b>95</b>    | <b>212</b>   |
| <b>Other financial income:</b>   |                         |              |              |
| Income from financial receivables classified as non-current assets   | 9                       | 15           | 19           |
| Income from securities other than investments, classified as non-current assets  | 14                      |              | 1            |
| Income from securities other than investments, classified as current assets  | 19                      | 31           | 52           |
| <b>Income other than the above:</b>  |                         |              |              |
| Interest income  | 243                     | 219          | 164          |
| Foreign exchange gains   | 559                     | 596          | 315          |
| Income from fair value hedging derivatives   | 474                     | 465          | 290          |
| Reversal of the Reserve for fair value adjustments to cash flow hedging derivatives (interest rate component) to the statement of income | 327                     | 180          | 56           |
| Income from non-hedging derivatives  | 34                      | 80           | 166          |
| Miscellaneous financial income   | 177                     | 476          | 137          |
|  | <b>(B) 1,856</b>        | <b>2,062</b> | <b>1,200</b> |

|   |           |                   |                   |                   |
|---|-----------|-------------------|-------------------|-------------------|
| <b>Positive fair value adjustments :</b>                                      |           |                   |                   |                   |
| Fair value hedging derivatives  |           | 34                | 693               | 88                |
| Underlying financial assets and liabilities of fair value hedging derivatives |           | 767               | 167               | 548               |
| Non-hedging derivatives   |           | 143               | 124               | 148               |
|   |           | <u>          </u> | <u>          </u> | <u>          </u> |
|   | (C)       | <b>944</b>        | <b>984</b>        | <b>784</b>        |
|   |           | <u>          </u> | <u>          </u> | <u>          </u> |
| <b>Impairment reversals on financial assets</b>                               | (D)       | <b>1</b>          | <b>3</b>          | <b>28</b>         |
|   |           | <u>          </u> | <u>          </u> | <u>          </u> |
| <b>Total</b>  | (A+B+C+D) | <b>3,041</b>      | <b>3,144</b>      | <b>2,224</b>      |
|   |           | <u>          </u> | <u>          </u> | <u>          </u> |

**Income from investments** ( 240 million) in 2006 increased by 145 million compared to 2005 ( 95 million) and mainly includes gains realized on the sale of the entire 4.99% holding in Neuf Télécom ( 148 million) and the investment in Avea I.H.A.S ( 72 million).

In 2005, such item ( 95 million) referred to gains on the sale of C-Mobil ( 61 million), Intelsat ( 2 million) and Golden Lines ( 5 million).

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In 2004, such income ( 212 million) referred to the gain on the sale of the residual interest in Telekom Austria ( 86 million) and the gain connected with the sale of the remaining stake in Mirror International ( 85 million).

**Foreign exchange gains** ( 559 million) decreased by 37 million in 2006 compared to 2005 ( 596 million) and increased by 281 million in 2005 compared to 2004 ( 315 million). Foreign exchange gains in 2006 are net of 313 million for the foreign exchange losses originating from the reversal of the Reserve for fair value adjustments to cash flow hedge derivatives to the statement of income ( 21 million in 2005 and 178 million in 2004). The counterbalance of foreign exchange gains is represented by foreign exchange losses which amount to 586 million in 2006 ( 538 million in 2005 and 336 million in 2004). Additional information is provided in the Note 37-Financial expenses .

**Income from fair value hedging derivatives** ( 474 million) increased by 9 million compared to 2005 ( 465 million) and by 175 million compared to 2004 ( 290 million). Income from fair value hedge derivatives in 2006 includes 444 million on CCIRS contracts ( 159 million in 2005) and 30 million on IRS contracts ( 306 million in 2005).

The positive effect of the **reversal of the Reserve for fair value adjustments to cash flow hedging derivatives (interest rate component) to the statement of income** ( 327 million) increased in 2006 by 147 million compared to 2005 ( 180 million) and by 124 million in 2005 compared to 2004 ( 56 million). This item in 2006 refers to CCIRS contracts for 269 million ( 125 million in 2005) and IRS contracts for 58 million ( 55 million in 2005).

**Income from non-hedging derivatives** ( 34 million) in 2006 decreased by 46 million compared to 2005 ( 80 million) and by 86 million in 2005 compared to 2004 ( 166 million). Such item in 2006 refers to CCIRS contracts for 7 million ( 6 million in 2005) and IRS contracts for 21 million ( 56 million in 2005) and other derivative contracts for 6 million ( 18 million in 2005).

**Miscellaneous financial income** ( 177 million) in 2006 decreased by 299 million compared to 2005 ( 476 million) and increased in 2005 by 339 million compared to 2004 ( 137 million). The increase in 2006 is mainly due to the lower effect on income in 2006 ( 121 million) compared to 2005 ( 423 million) of the release to income of provisions recorded for sureties provided to the banks which had financed Avea I.H.A.S., since there was no longer a risk because the guarantees themselves were cancelled.

**Positive fair value adjustments to fair value hedging derivatives** ( 34 million) decreased in 2006 by 659 million compared to 2005 ( 693 million) and increased in 2005 by 605 million compared to 2004 ( 88 million). The counterbalance of this amount is represented by negative fair value adjustments to the underlying financial assets and liabilities of fair value hedging derivatives which amount to 70 million in 2006, 689 million in 2005 and 88 million in 2004. Additional information is provided in the Note 37-Financial expenses .

**Positive fair value adjustments to the underlying financial assets and liabilities of fair value hedging derivatives** ( 767 million) increased in 2006 by 600 million compared to 2005 ( 167 million) and decreased in 2005 by 381 million compared to 2004 ( 548 million). The counterbalance of this item is represented by negative fair value adjustments to the corresponding fair value hedging derivatives which amount to 758 million in 2006, 157 million in 2005 and 547 million in 2004. Additional information is provided in the Note 37-Financial expenses .

**Positive fair value adjustments to non-hedging derivatives** ( 143 million) increased in 2006 by 19 million compared to 2005 ( 124 million) and decreased in 2005 by 24 million compared to 2004 ( 148 million). Such item in 2006 includes, in particular, 30 million for the fair value adjustment of the call option on Sofora shares ( 45 million in 2005).

#### **NOTE 37 FINANCIAL EXPENSES**

**Financial expenses** amount to 5,014 million in 2006, 5,131 million in 2005 and 4,216 million in 2004, showing a decrease of 117 million in 2006 compared to 2005 and an increase in 2005 of 915 compared to 2004.

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Details are as follows:

|  | Year ended December 31, |              |              |
|--|-------------------------|--------------|--------------|
|  | 2006                    | 2005         | 2004         |
|  | (millions of Euro)      |              |              |
| <b>Charges from investments</b>  | <b>(A)</b>              |              |              |
| <b>Interest expenses and other borrowing costs:</b>  |                         |              |              |
| Interest expenses and other costs relating to notes and bonds  | 1,889                   | 2,056        | 2,064        |
| Interest expenses to banks   | 363                     | 296          | 45           |
| Interest expenses to others  | 237                     | 214          | 224          |
|  | <u>2,489</u>            | <u>2,566</u> | <u>2,333</u> |
| Commissions  | 27                      | 61           | 82           |
| Foreign exchange losses  | 586                     | 538          | 336          |
| Charges from fair value hedging derivatives  | 364                     | 264          | 152          |
| Reversal of the Reserve for fair value adjustments of cash flow hedging derivatives (interest rate component) to the statement of income | 326                     | 255          | 155          |
| Charges from non-hedging derivatives   | 69                      | 170          | 114          |
| Miscellaneous financial expenses   | 216                     | 223          | 156          |
|  | <u>4,077</u>            | <u>4,077</u> | <u>3,328</u> |
| <b>Negative fair value adjustments :</b>   |                         |              |              |
| Fair value hedging derivatives   | 758                     | 157          | 547          |
| Underlying financial assets and liabilities of fair value hedges   | 70                      | 689          | 88           |
| Non-hedging derivatives  | 100                     | 184          | 149          |
|  | <u>928</u>              | <u>1,030</u> | <u>784</u>   |
| <b>Impairment losses on financial assets (investments and securities other than investments)</b>   | <b>(D)</b>              |              |              |
|  | <u>9</u>                | <u>24</u>    | <u>104</u>   |
| <b>Total</b>   | <b>(A+B+C+D)</b>        |              |              |
|  | <u>5,014</u>            | <u>5,131</u> | <u>4,216</u> |

**Interest expense and other borrowing costs relating to notes and bonds, and due to banks and others** ( 2,489 million), decreased in 2006 by 77 million compared to 2005 ( 2,566 million) and increased in 2005 by 233 million compared to 2004 ( 2,333 million). The decrease in 2006 mainly is the result of a reduction in the average debt exposure which was partially offset by the negative effect of a rise in interest rates on a portion of floating-rate debt, whereas the increase in 2005 is mainly due to the financing of the Cash Tender Offer on TIM shares.

**Foreign exchange losses** ( 586 million) increased in 2006 by 48 million compared to 2005 ( 538 million) and by 202 million in 2005 compared to 2004 ( 336 million). Foreign exchange losses in 2006 are net of 23 million for the foreign exchange gains arising from the reversal of the Reserve for fair value adjustments of cash flow hedging derivatives to the statement of income ( 341 million in 2005). The counterbalance of foreign exchange losses is represented by the Foreign exchange gains which amount to 559 million

in 2006 ( 596 million in 2005 and 315 million in 2004). Additional information is provided in Note 36-Financial income .

**Charges from fair value hedging derivatives** ( 364 million) increased in 2006 by 100 million compared to 2005 ( 264 million) and by 112 million in 2005 compared to 2004 ( 152 million in 2004). Such charges in 2006 include 292 million on CCIRS contracts ( 89 million in 2005) and 72 million on IRS contracts ( 175 million in 2005).

The negative effect of the **reversal of the Reserve for fair value adjustments of cash flow hedging derivatives (interest rate component) to the statement of income** ( 326 million) increased in 2006 by 71 million compared to 2005 ( 255 million) and by 100 million compared to 2004 ( 155 million). Such item, in particular, in 2006 refers to CCIRS contracts for 212 million ( 138 million in 2005) and IRS contracts for 114 million ( 117 million in 2005).

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**Charges from non-hedging derivatives** ( 69 million) decreased in 2006 by 101 million compared to 2005 ( 170 million) and increased in 2005 by 56 million compared to 2004 ( 114 million). Such charges in 2006 include 32 million on CCIRS contracts ( 121 million in 2005), 23 million on IRS contracts ( 22 million in 2005) and 14 million on other derivative contracts ( 28 million in 2005).

**Negative fair value adjustments to fair value hedging derivatives** ( 758 million) increased in 2006 by 601 million compared to 2005 ( 157 million) and decreased in 2005 by 390 million compared to 2004 ( 547 million). The counterbalance of this item is represented by the positive fair value adjustments to the underlying financial assets and liabilities of fair value hedging derivatives which amount to 767 million in 2006, 167 million in 2005 and 548 million in 2004. Additional information is provided in Note 36-Financial income .

**Negative fair value adjustments to underlying financial assets and liabilities of fair value hedging derivatives** ( 70 million) decreased in 2006 by 619 million compared to 2005 ( 689 million) and increased in 2005 by 601 million compared to 2004 ( 88 million). The counterbalance of this item is represented by the positive fair value adjustments to the corresponding fair value hedge derivatives which amount to 34 million in 2006 ( 693 million in 2005 and 88 million in 2004). Additional information is provided in Note 36-Financial income .

**Negative fair value adjustments to non-hedging derivatives** ( 100 million) decreased in 2006 by 84 million compared to 2005 ( 184 million) and increased in 2005 by 35 million compared to 2004 ( 149 million).

**NOTE 38 INCOME TAXES**

Income taxes for the years ended December 31, 2006, 2005 and 2004 are detailed as follows:

|  | Year ended December 31, |              |              |
|--|-------------------------|--------------|--------------|
|  | 2006                    | 2005         | 2004         |
|  | (millions of Euro)      |              |              |
| Current taxes for the year                         | 760                     | 1,017        | 1,387        |
| Current taxes for prior years                      | 15                      | 29           | 10           |
| Reversal of prior years income tax liabilities     | (93)                    | (37)         | (16)         |
| <b>Total current taxes</b>                         | <b>682</b>              | <b>1,009</b> | <b>1,381</b> |
| Deferred taxes                                     | 1,837                   | 1,386        | 1,273        |
| <b>Total income taxes on continuing operations</b> | <b>(A) 2,519</b>        | <b>2,395</b> | <b>2,654</b> |
| Current taxes for the year                         |                         | 23           | 79           |
| Deferred taxes                                     |                         | 8            | 16           |

|   |              |              |              |
|---|--------------|--------------|--------------|
| <b>Total income taxes on discontinued operations/assets held for sale</b> | <b>(B)</b>   | <b>31</b>    | <b>95</b>    |
| <b>Total income taxes for the year</b>                                    | <b>(A+B)</b> | <b>2,519</b> | <b>2,426</b> |
|   |              | <b>2,749</b> |              |

Incomes taxes on discontinued operations/assets held for sale are classified in the statement of income in Net income (loss) from discontinued operations/assets held for sale .

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Income before taxes and the income tax charge for the years ended December 31, 2006, 2005 and 2004 are summarized as follows:

|   | Year ended December 31, |              |              |
|---|-------------------------|--------------|--------------|
|   | 2006                    | 2005         | 2004         |
|   | (millions of Euro)      |              |              |
| <b>Income before taxes:</b>                         |                         |              |              |
| • from continuing operations                        | 5,515                   | 5,535        | 5,606        |
| • from discontinued operations/assets held for sale | 7                       | 581          | (23)         |
| <b>Total income before taxes</b>                    | <b>5,522</b>            | <b>6,116</b> | <b>5,583</b> |
| <i>Of which:</i>                                    |                         |              |              |
| • Italy   | 5,296                   | 5,789        | 6,153        |
| • Abroad  | 226                     | 327          | (570)        |
| <b>Current taxes:</b>                               |                         |              |              |
| • Italy   | 641                     | 957          | 1,359        |
| • Abroad  | 41                      | 75           | 101          |
| <b>Total current taxes (A)</b>                      | <b>682</b>              | <b>1,032</b> | <b>1,460</b> |
| <b>Deferred taxes:</b>                              |                         |              |              |
| • Italy   | 1,775                   | 1,457        | 1,227        |
| • Abroad  | 62                      | (63)         | 62           |
| <b>Total deferred taxes (B)</b>                     | <b>1,837</b>            | <b>1,394</b> | <b>1,289</b> |
| <b>Total income taxes (A+B)</b>                     | <b>2,519</b>            | <b>2,426</b> | <b>2,749</b> |

|   | Year ended December 31, |              |              |
|---|-------------------------|--------------|--------------|
|   | 2006                    | 2005         | 2004         |
|   | (millions of Euro)      |              |              |
| <b>Income taxes:</b>                                |                         |              |              |
| • from continuing operations                        | 2,519                   | 2,395        | 2,654        |
| • from discontinued operations/assets held for sale |                         | 31           | 95           |
| <b>Total income taxes</b>                           | <b>2,519</b>            | <b>2,426</b> | <b>2,749</b> |

The reconciliation of the income taxes on the pretax income of the Group at the tax rate in force and at the effective tax rate for the years ended December 31, 2006, 2005 and 2004 is the following:

|  | Year ended December 31, |            |                       |            |                       |            |
|--|-------------------------|------------|-----------------------|------------|-----------------------|------------|
|  | 2006                    |            | 2005                  |            | 2004                  |            |
|  | (millions<br>of Euro)   | rate       | (millions<br>of Euro) | rate       | (millions<br>of Euro) | rate       |
| <b>Income before taxes</b>   | <b>5,522</b>            |            | <b>6,116</b>          |            | <b>5,488</b>          |            |
| Taxes calculated at the 33% tax rate in force  | 1,822                   | 33%        | 2,018                 | 33%        | 1,811                 | 33%        |
| Tax losses for the year not considered recoverable   | 127                     | 2%         | 81                    | 1%         | 168                   | 3%         |
| Tax losses not considered recoverable in previous years and recovered during the year        | (39)                    | (1%)       | (3)                   |            | (15)                  |            |
| Deferred tax benefits not recorded in prior years and considered recoverable during the year | (7)                     |            | (21)                  |            | (161)                 | (3%)       |
| Reversal of the provision for deferred taxes   |                         |            | (136)                 | (2%)       |                       |            |
| Non-deductible costs   | 57                      | 1%         | 156                   | 3%         | 290                   | 5%         |
| Other net differences  | 31                      | 1%         | (180)                 | (3%)       | (84)                  | (1%)       |
| IRAP and other taxes calculated on a different basis other than income before taxes          | 528                     | 10%        | 511                   | 8%         | 740                   | 13%        |
| <b>Total effective taxes recognized in the statement of income</b>                           | <b>2,519</b>            | <b>46%</b> | <b>2,426</b>          | <b>40%</b> | <b>2,749</b>          | <b>50%</b> |

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Subsequent to the enactment of Legislative Decree No. 10 dated February 15, 2007, it became possible to recover withholding taxes improperly withheld by the Parent, Telecom Italia, on the companies of the Group residing in the European Union, for an amount of approximately 133 million. Therefore, this amount will be recognized in the 2007 statement of income as deduction from the tax charge.

**NOTE 39 EARNINGS PER SHARE**

The potential shares originating from the conversions of stock options and convertible bonds have an anti-dilutive effect and therefore the corresponding shares have not been considered in the calculation of earnings per share.

The additional dividends (at an invariable amount of 0.011 per share) due conventionally to the savings shares were entirely allocated to continuing operations.

|  | Year ended December 31, |              |              |
|--|-------------------------|--------------|--------------|
|  | 2006                    | 2005         | 2004         |
| <b>Basic and Diluted Earnings Per Share</b>                            |                         |              |              |
| Net income attributable to equity holders of the Parent                | 3,014                   | 3,216        | 1,815        |
| Less: additional dividend per Savings Shares ( 0.011 per share)        | (66)                    | (65)         | (64)         |
| (millions of Euro)   | <b>2,948</b>            | <b>3,151</b> | <b>1,751</b> |
| Weighted average number of Ordinary and Savings Shares (million)       | 19,281                  | 18,213       | 16,004       |
| Basic and diluted earnings per share Ordinary Shares                   | 0.15                    | 0.17         | 0.11         |
| Plus: additional dividend per Savings Share ( 0.011 per share)         | 0.01                    | 0.01         | 0.01         |
| Basic and diluted earnings per share Savings Shares (Euro)             | <b>0.16</b>             | <b>0.18</b>  | <b>0.12</b>  |
| <b>Basic and Diluted Earnings Per Share From Continuing Operations</b> |                         |              |              |
| Net income from continuing operations                                  | 3,007                   | 2,666        | 1,933        |
| Less: additional dividend per Savings Shares ( 0.011 per share)        | (66)                    | (65)         | (64)         |
| (millions of Euro)   | <b>2,941</b>            | <b>2,601</b> | <b>1,869</b> |

|   |            |                    |                    |                    |
|---|------------|--------------------|--------------------|--------------------|
| Weighted average number of Ordinary and Savings Shares                          | (millions) | <u>19,281</u>      | <u>18,213</u>      | <u>16,004</u>      |
| Basic and diluted earnings per share from continuing operations Ordinary Shares |            | 0.15               | 0.14               | 0.12               |
| Plus: additional dividend per Savings Shares ( 0.011 per share)                 |            | <u>0.01</u>        | <u>0.01</u>        | <u>0.01</u>        |
| Basic and diluted earnings per share from continuing operations Savings Shares  | (Euro)     | <b><u>0.16</u></b> | <b><u>0.15</u></b> | <b><u>0.13</u></b> |

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|---|----------------------|--|-----------------------|-----------------------|
|   |                      | Year ended December 31,                    |                       |                       |
|   |                      | 2006                                       | 2005                  | 2004                  |
| <b>Basic and Diluted Earnings Per Share From Discontinued Operations/Assets Held For Sale</b>                 |                      |  |                       |                       |
| Net income (loss) from discontinued operations/assets held for sale   | (millions of Euro)   | 7  | 550                   | (118)                 |
| Weighted average number of Ordinary and Savings Shares  | (millions)           | 19,281                                     | 18,213                | 16,004                |
| Basic and diluted earnings (loss) per share from discontinued operations/assets held for sale Ordinary Shares | (Euro)               |  | 0.03                  | (0.01)                |
| Basic and diluted earnings (loss) per share from discontinued operations/assets held for sale Savings Shares  | (Euro)               |  | 0.03                  | (0.01)                |
| Weighted average number of Ordinary Shares  |                      | 13,254,860,233                             | 12,283,195,845        | 10,208,327,613        |
| Weighted average number of Savings Shares   |                      | 6,026,120,661                              | 5,930,204,164         | 5,795,921,069         |
| <b>Total</b>  |                      | <b>19,280,980,894</b>                      | <b>18,213,400,009</b> | <b>16,004,248,682</b> |

**NOTE 40 SEGMENT INFORMATION****a) Information by business segment**

The disclosure by business segment has been modified to present the Brazil Mobile segment separately from the Domestic Mobile segment in light of the increasing importance of the Brazilian mobile business and the organizational changes that took place during 2006.

In order to facilitate the comparability of the data, the segment information presented for prior periods has been reclassified for purposes of comparison.

The accounting representation by business segment is as follows:

- Wireline
- Domestic Mobile
- Brazil Mobile
- Media
- Olivetti
- Other activities

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| Line | Domestic Mobile    |         |         |         |         |         | Brazil Mobile |       |       | Media |       |       | Olivetti |         |         | Other activities |         |         | Adjustments and eliminations |  |  |
|------|--------------------|---------|---------|---------|---------|---------|---------------|-------|-------|-------|-------|-------|----------|---------|---------|------------------|---------|---------|------------------------------|--|--|
|      | 2004               | 2006    | 2005    | 2004    | 2006    | 2005    | 2004          | 2006  | 2005  | 2004  | 2006  | 2005  | 2004     | 2006    | 2005    | 2004             | 2006    | 2005    | 2004                         |  |  |
|      | (millions of Euro) |         |         |         |         |         |               |       |       |       |       |       |          |         |         |                  |         |         |                              |  |  |
| 356  | 15,843             | 9,939   | 9,776   | 9,661   | 3,959   | 2,895   | 1,795         | 197   | 176   | 165   | 385   | 400   | 536      | 369     | 316     | 292              |         |         |                              |  |  |
| 478  | 1,665              | 271     | 300     | 262     | 5       | 5       | 5             | 10    | 4     | 3     | 55    | 52    | 54       | 1,194   | 1,005   | 997              | (2,904) | (2,844) | (2,986)                      |  |  |
| 334  | 17,508             | 10,210  | 10,076  | 9,923   | 3,964   | 2,900   | 1,800         | 207   | 180   | 168   | 440   | 452   | 590      | 1,563   | 1,321   | 1,289            | (2,904) | (2,844) | (2,986)                      |  |  |
| 302  | 619                | 177     | 162     | 234     | 65      | 30      | 150           | 13    | 11    | 20    | 27    | 22    | 18       | 102     | 227     | 150              | (47)    | (76)    | (92)                         |  |  |
| 136  | 18,127             | 10,387  | 10,238  | 10,157  | 4,029   | 2,930   | 1,950         | 220   | 191   | 188   | 467   | 474   | 608      | 1,665   | 1,548   | 1,439            | (2,951) | (2,920) | (3,078)                      |  |  |
| 426  | (6,864)            | (4,837) | (4,529) | (4,387) | (2,210) | (1,804) | (1,259)       | (213) | (200) | (161) | (397) | (388) | (443)    | (1,715) | (1,386) | (1,361)          | 2,873   | 2,796   | 2,663                        |  |  |
| 327  | (2,673)            | (469)   | (548)   | (517)   | (208)   | (159)   | (114)         | (76)  | (75)  | (69)  | (91)  | (100) | (111)    | (324)   | (456)   | (391)            | 2       | 23      | 23                           |  |  |
| 122  | (139)              | (17)    | (30)    | (19)    |         |         |               | (3)   | (3)   | (3)   | (4)   | (5)   | (6)      | (12)    | (8)     | (16)             |         |         |                              |  |  |
| 560  | (1,016)            | (147)   | (131)   | (110)   | (642)   | (509)   | (319)         | (14)  | (12)  | (27)  | (11)  | (11)  | (25)     | (112)   | (273)   | (144)            | 22      | 28      | 38                           |  |  |
| 358  | (612)              | (38)    | (44)    | (46)    | (174)   | (130)   | (70)          | (3)   | (4)   | (4)   | (9)   | (6)   | (16)     | (10)    | (50)    | (39)             |         |         |                              |  |  |
| (30) | 38                 | 38      | 6       |         | (19)    | 8       | (7)           | (1)   | 3     | 1     | (1)   | 9     | (1)      | (3)     |         | (4)              |         |         |                              |  |  |
| 357  | 311                | 70      | 50      | 38      |         |         |               | 1     | 2     | 4     |       | 1     |          |         | 1       |                  | 43      | 60      | 360                          |  |  |
| 125  | (3,084)            | (1,296) | (1,224) | (1,165) | (930)   | (645)   | (382)         | (55)  | (38)  | (28)  | (18)  | (16)  | (16)     | (235)   | (248)   | (211)            | 57      | 64      | 78                           |  |  |
| (25) | (3)                | (3)     | 2       |         | 1       | (2)     | (3)           | 1     | (1)   | 1     | 1     |       | 8        | 142     | 268     | 10               |         |         | (22)                         |  |  |

|      |       |       |       |       |    |       |       |       |       |      |      |      |    |       |       |       |    |       |       |
|------|-------|-------|-------|-------|----|-------|-------|-------|-------|------|------|------|----|-------|-------|-------|----|-------|-------|
| (12) | (127) | (1)   | (8)   | (6)   |    | (9)   | (3)   |       |       | (2)  | (7)  | (3)  |    | (1)   | (30)  | 1     | 9  | (273) |       |
| 488  | 4,709 | 3,742 | 3,856 | 4,010 | 21 | (190) | (137) | (137) | (130) | (93) | (50) | (38) | 17 | (582) | (547) | (692) | 47 | 60    | (211) |

|   |   |  |  |  |  |  |  |  |  |  |  |  |  |    |    |     |  |  |  |
|---|---|--|--|--|--|--|--|--|--|--|--|--|--|----|----|-----|--|--|--|
| 2 | 1 |  |  |  |  |  |  |  |  |  |  |  |  | 52 | 21 | (6) |  |  |  |
|---|---|--|--|--|--|--|--|--|--|--|--|--|--|----|----|-----|--|--|--|

operations before taxes

ing operations

continued operations /assets held for sale

le to equity holders of the Parent  
 ibutable to Minority Interests

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|                    | Wireline     |              |              | Domestic Mobile |              |              | Brazil Mobile |            |            | Media     |           |           | Olivetti  |           |           | Other activities |            |            | Adjustments and eliminations |            |      | Consolidated Total |       |              |              |              |       |
|--------------------|--------------|--------------|--------------|-----------------|--------------|--------------|---------------|------------|------------|-----------|-----------|-----------|-----------|-----------|-----------|------------------|------------|------------|------------------------------|------------|------|--------------------|-------|--------------|--------------|--------------|-------|
|                    | 2006         | 2005         | 2004         | 2006            | 2005         | 2004         | 2006          | 2005       | 2004       | 2006      | 2005      | 2004      | 2006      | 2005      | 2004      | 2006             | 2005       | 2004       | 2006                         | 2005       | 2004 | 2006               | 2005  | 2004         |              |              |       |
| (millions of Euro) |              |              |              |                 |              |              |               |            |            |           |           |           |           |           |           |                  |            |            |                              |            |      |                    |       |              |              |              |       |
| Intangible assets  | 1,121        | 851          | 1,017        | 608             | 605          | 648          | 357           | 244        | 116        | 56        | 38        | 23        | 1         | 1         | 73        | 54               | 77         | (28)       | (8)                          |            |      |                    | 2,187 | 1,785        | 1,882        |              |       |
| Tangible assets    | 1,881        | 1,972        | 1,432        | 538             | 671          | 821          | 342           | 598        | 701        | 29        | 27        | 16        | 10        | 18        | 14        | 127              | 102        | 136        |                              |            |      |                    |       |              | 2,927        | 3,388        | 3,120 |
| <b>Total</b>       | <b>3,002</b> | <b>2,823</b> | <b>2,449</b> | <b>1,146</b>    | <b>1,276</b> | <b>1,469</b> | <b>699</b>    | <b>842</b> | <b>817</b> | <b>85</b> | <b>65</b> | <b>39</b> | <b>10</b> | <b>19</b> | <b>15</b> | <b>200</b>       | <b>156</b> | <b>213</b> | <b>(28)</b>                  | <b>(8)</b> |      |                    |       | <b>5,114</b> | <b>5,173</b> | <b>5,002</b> |       |

**Employees at the year end by business segment**

|                       | Wireline                |                         | Domestic Mobile         |                         | Brazil Mobile           |                         | Media                   |                         | Olivetti                |                         | Other activities        |                         | Consolidated            |                         |
|-----------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
|                       | As of December 31, 2006 | As of December 31, 2005 | As of December 31, 2006 | As of December 31, 2005 | As of December 31, 2006 | As of December 31, 2005 | As of December 31, 2006 | As of December 31, 2005 | As of December 31, 2006 | As of December 31, 2005 | As of December 31, 2006 | As of December 31, 2005 | As of December 31, 2006 | As of December 31, 2005 |
| (number of employees) |                         |                         |                         |                         |                         |                         |                         |                         |                         |                         |                         |                         |                         |                         |
| Employees(*)          | 55,705                  | 56,987                  | 11,218                  | 11,720                  | 9,531                   | 9,043                   | 919                     | 886                     | 1,428                   | 1,750                   | 4,408                   | 5,098                   | 83,209                  |                         |

(\*) Employees at year end do not take account of those relating to Discontinued Operations/Assets held for sale.

**Other information by business segment**

|                    | Wireline                |                         | Domestic Mobile         |                         | Brazil Mobile           |                         | Media                   |                         | Olivetti                |                         | Other activities        |                         | Adjustments and eliminations |                         | Consolidated Total |
|--------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|------------------------------|-------------------------|--------------------|
|                    | As of December 31, 2006 | As of December 31, 2005 | As of December 31, 2006 | As of December 31, 2005 | As of December 31, 2006 | As of December 31, 2005 | As of December 31, 2006 | As of December 31, 2005 | As of December 31, 2006 | As of December 31, 2005 | As of December 31, 2006 | As of December 31, 2005 | As of December 31, 2006      | As of December 31, 2005 |                    |
| (millions of Euro) |                         |                         |                         |                         |                         |                         |                         |                         |                         |                         |                         |                         |                              |                         |                    |
|                    | 35,561                  | 34,714                  | 35,797                  | 5,379                   | 5,627                   | 646                     | 591                     | 323                     | 305                     | 2,476                   | 4,113                   | (533)                   | (3,193)                      |                         |                    |

|  |     |       |       |       |       |       |     |     |     |     |       |       |       |         |
|--|-----|-------|-------|-------|-------|-------|-----|-----|-----|-----|-------|-------|-------|---------|
|  | 7   | 7     |       |       |       |       |     | 1   | 1   | 480 | 773   |       |       |         |
| itions/assets held for sale                    |     |       |       |       |       |       |     |     |     |     |       |       |       |         |
|  |     |       |       |       |       |       |     |     |     |     |       |       |       |         |
|  |     |       |       |       |       |       |     |     |     |     |       |       |       |         |
|  | 210 | 9,646 | 3,542 | 4,467 | 1,277 | 1,605 | 189 | 201 | 257 | 252 | 1,059 | 2,659 | (424) | (2,882) |
| o discontinued operations/assets held for sale |     |       |       |       |       |       |     |     |     |     |       |       |       |         |
| es   |     |       |       |       |       |       |     |     |     |     |       |       |       |         |
|  |     |       |       |       |       |       |     |     |     |     |       |       |       |         |
| <b>abilities</b>                               |     |       |       |       |       |       |     |     |     |     |       |       |       |         |

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|   |             | Discontinued operations/assets held for sale   |          |                      |           |           | Other, adjustments and eliminations(3) |        | Total |
|---|-------------|--|----------|----------------------|-----------|-----------|--|--------|-------|
|   |             | Mobile(1)                                      | Media(2) | Entel<br>Chile group | IT Market | Sub Total |  |        |       |
|   |             | (millions of Euro, except number of employees) |          |                      |           |           |  |        |       |
| Revenues  | 2006        | 121  |          |                      |           | 121       | (1)                                    | 120    |       |
|   | 2005        | 734  | 126      | 238                  | 289       | 1,387     | (53)                                   | 1,334  |       |
|   | 2004        | 1,177  | 127      | 925                  | 706       | 2,935     | (142)                                  | 2,793  |       |
| Operating income (loss)(3)  | 2006        | 15   |          |                      |           | 15        | (8)                                    | 7      |       |
|   | 2005        | 60   | 4        | 36                   | (3)       | 97        | 506                                    | 603    |       |
|   | 2004        | 125  | 4        | 96                   | 21        | 246       | (202)                                  | 44     |       |
| Net income (loss) from discontinued operations/assets held for sale | 2006        | 15   |          |                      |           | 15        | (8)                                    | 7      |       |
|   | 2005        | 28   | 1        | 26                   | (11)      | 44        | 506                                    | 550    |       |
|   | 2004        | 58   | 1        | 49                   | (7)       | 101       | (219)                                  | (118)  |       |
| Capital expenditures  | 2006        | 10   |          |                      |           | 10        |  | 10     |       |
|   | 2005        | 87   | 3        | 27                   | 5         | 122       |  | 122    |       |
|   | 2004        | 200  | 2        | 141                  | 28        | 371       |  | 371    |       |
| Number of employees at year-end                                     | 2006        |  |          |                      |           |           |  |        |       |
|   | 2005        | 863  | 184      |                      |           | 1,047     |  | 1,047  |       |
|   | 2004        |  |          |                      |           |           |  |        |       |
|   | adjusted(4) | 2,961  | 195      | 4,216                | 4,030     | 11,402    |  | 11,402 |       |
|   | 2004        | 841  |          |                      | 4,030     | 4,871     |  | 4,871  |       |

(1) Includes: Tim Hellas (sold at the beginning of June 2005), Tim Perù (sold in August 2005) and Digital Venezuela (sold in May 2006).

(2) Includes the Gruppo Buffetti (sold in January 2006).

(3) Adjustments and eliminations relating to the operating income (loss) include, among other things:

2006: the gain net of the related incidental charges and provisions for risks and charges on the sale of Digital Venezuela ( 22 million) and a provision relating to Tim Hellas, a company sold in 2005 ( 30 million);

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2005: the gain on the sale of Tim Hellas ( 410 million, net of the related incidental charges) and Tim Perù ( 120 million), as well as other losses and incidental charges relating to the sale of the Entel Chile group and the Finsiel Group ( 24 million);

2004: the adjustment of the estimated selling price of the Entel Chile group (a loss of 177 million) and the Finsiel group (a loss of 28 million).

- (4) The numbers of employees at December 31, 2006 and at December 31, 2005 are compared both with the adjusted number of employees at December 31, 2004 (which considers as discontinued operations / assets held for sale the same companies considered as such at December 31, 2006 and 2005, namely: the Finsiel Group, Digital Venezuela, the Entel Chile group, Tim Hellas, Tim Perù and Gruppo Buffetti) and with the historical number of employees at December 31, 2004 (which considers as discontinued operations / assets held for sale the Finsiel Group and Digital Venezuela).

### b) Information by geographical segment:

Geographical segment information on revenues by geographical location of the Group's customers:

|                          | Year ended December 31, |               |               |
|--------------------------|-------------------------|---------------|---------------|
|                          | 2006                    | 2005          | 2004          |
|                          | (millions of Euro)      |               |               |
| Italy                    | 23,306                  | 23,754        | 23,736        |
| Europe (excluding Italy) | 2,946                   | 2,265         | 1,746         |
| Latin America            | 4,220                   | 3,147         | 2,036         |
| Other countries          | 803                     | 753           | 774           |
| <b>Total</b>             | <b>31,275</b>           | <b>29,919</b> | <b>28,292</b> |

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Operating assets by geographical segment:

|                          | <u>2006</u>          | <u>2005</u>          |
|--------------------------|----------------------|----------------------|
|                          | (millions of Euro)   |                      |
| Italy                    | 70,152               | 71,070               |
| Europe (excluding Italy) | 1,780                | 1,724                |
| Latin America            | 5,650                | 5,962                |
| Other countries          | 20                   | 45                   |
| <b>Total</b>             | <b><u>77,602</u></b> | <b><u>78,801</u></b> |

Capital expenditures in tangible and intangible assets by geographical segment:

|                          | <u>2006</u>         | <u>2005</u>         | <u>2004</u>         |
|--------------------------|---------------------|---------------------|---------------------|
|                          | (millions of Euro)  |                     |                     |
| Italy                    | 3,918               | 3,992               | 3,955               |
| Europe (excluding Italy) | 467                 | 313                 | 204                 |
| Latin America            | 719                 | 861                 | 835                 |
| Other countries          | 10                  | 7                   | 8                   |
| <b>Total</b>             | <b><u>5,114</u></b> | <b><u>5,173</u></b> | <b><u>5,002</u></b> |

Employees by geographical segment:

|                          | <u>Executives</u>                 | <u>Middle management</u> | <u>White collars</u> | <u>Blue collars</u> | <u>Personnel with temp work contracts</u> | <u>Total at December 31, 2006</u> | <u>Total at December 31, 2005</u> |
|--------------------------|-----------------------------------|--------------------------|----------------------|---------------------|---|-----------------------------------|-----------------------------------|
|                          | (number of employees at year end) |                          |                      |                     |   |                                   |                                   |
| Italy                    | 1,207                             | 4,277                    | 61,262               | 431                 | 1,646                                     | 68,823                            | 71,987                            |
| Europe (excluding Italy) | 41                                | 442                      | 2,262                |                     | 626                                       | 3,371                             | 2,820                             |
| Latin America            | 45                                | 357                      | 10,152               |                     | 382                                       | 10,936                            | 10,604                            |
| Other countries          | 9                                 | 36                       | 34                   |                     |   | 79                                | 73                                |
| <b>Total</b>             | <b><u>1,302</u></b>               | <b><u>5,112</u></b>      | <b><u>73,710</u></b> | <b><u>431</u></b>   | <b><u>2,654</u></b>                       | <b><u>83,209</u></b>              | <b><u>85,484</u></b>              |

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

The balances relating to transactions with related parties and the effects of these amounts on the statement of income and the statement of cash flows for the years ended December 31, 2006, 2005 and 2004 and the balance sheet as of December 31, 2006 and 2005 are presented in the following tables:

|  | Transactions with related parties in the years ended December 31, |            |            | Corresponding captions in consolidated financial statements as of December 31, |               |               | % impact of related parties |            |            |
|--|---|------------|------------|--|---------------|---------------|-----------------------------|------------|------------|
|  | 2006  | 2005       | 2004       | 2006   | 2005          | 2004          | 2006                        | 2005       | 2004       |
|  | (millions of Euro)  |            |            |  |               |               |                             |            |            |
| <b>Revenues</b>  |   |            |            |  |               |               |                             |            |            |
| Of which attributable to transactions with:  |   |            |            |  |               |               |                             |            |            |
| • associates and joint-ventures  | 270   | 336        | 310        |  |               |               |                             |            |            |
| • subsidiaries of associates and joint-ventures  | 176   | 104        | 13         |  |               |               |                             |            |            |
| • other related parties through Directors, Statutory Auditors and managers with key responsibilities | 18  | 33         | 40         |  |               |               |                             |            |            |
| • post-employment benefit plans  |   |            |            |  |               |               |                             |            |            |
|  | <b>464</b>  | <b>473</b> | <b>363</b> |  |               |               |                             |            |            |
| <b>Transactions of Discontinued Operations with related parties</b>                                  |   | (10)       |            |  |               |               |                             |            |            |
| <b>Total net of Discontinued Operations</b>  | <b>464</b>  | <b>463</b> | <b>363</b> | <b>31,275</b>  | <b>29,919</b> | <b>28,292</b> | <b>1.5</b>                  | <b>1.5</b> | <b>1.3</b> |
| <b>Other income</b>  |   |            |            |  |               |               |                             |            |            |
| Of which related to transactions with:   |   |            |            |  |               |               |                             |            |            |
| • associates and joint-ventures  | 6   | 6          | 5          |  |               |               |                             |            |            |
| • subsidiaries of associates and joint-ventures  | 1   |            |            |  |               |               |                             |            |            |
| • other related parties through Directors, Statutory Auditors and Managers with key responsibilities |   |            | 1          |  |               |               |                             |            |            |
| • post-employment benefit plans  |   |            |            |  |               |               |                             |            |            |
|  | <b>7</b>  | <b>6</b>   | <b>6</b>   |  |               |               |                             |            |            |
| <b>Total, net of Discontinued Operations</b>   | <b>7</b>  | <b>6</b>   | <b>6</b>   | <b>606</b>   | <b>678</b>    | <b>1,099</b>  | <b>1.2</b>                  | <b>0.9</b> | <b>0.5</b> |
| <b>Purchases of material and external services</b>   |   |            |            |  |               |               |                             |            |            |
| Of which related to transactions with:   |   |            |            |  |               |               |                             |            |            |
| • associates and joint-ventures  | 103   | 266        | 403        |  |               |               |                             |            |            |



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|  |            |            |            |               |               |               |            |            |            |
|--|------------|------------|------------|---------------|---------------|---------------|------------|------------|------------|
| • subsidiaries of associates and joint- ventures   | 61         | 36         | 29         |               |               |               |            |            |            |
| • other related parties through Directors, Statutory Auditors and managers with key responsibilities | 93         | 112        | 120        |               |               |               |            |            |            |
| • post-employment benefit plans  |            |            |            |               |               |               |            |            |            |
|  | <u>257</u> | <u>414</u> | <u>552</u> |               |               |               |            |            |            |
| <b>Transactions of Discontinued Operations with related parties</b>                                  |            | (5)        |            |               |               |               |            |            |            |
| <b>Net of Discontinued Operations</b>  | <u>257</u> | <u>409</u> | <u>552</u> | <u>14,191</u> | <u>12,937</u> | <u>11,812</u> | <u>1.8</u> | <u>3.2</u> | <u>4.7</u> |

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|  | Transactions with related parties in the years ended December 31, |           |           | Corresponding captions in consolidated financial statements as of December 31, |              |              | % impact of related parties |            |            |
|--|---|-----------|-----------|--|--------------|--------------|-----------------------------|------------|------------|
|  | 2006  | 2005      | 2004      | 2006   | 2005         | 2004         | 2006                        | 2005       | 2004       |
|  | (millions of Euro)  |           |           |  |              |              |                             |            |            |
| <b>Personnel costs</b>   |   |           |           |  |              |              |                             |            |            |
| Of which related to transactions with:   |   |           |           |  |              |              |                             |            |            |
| • associates and joint- ventures   |   |           |           |  |              |              |                             |            |            |
| • subsidiaries of associates and joint- ventures   |   |           |           |  |              |              |                             |            |            |
| • other related parties through Directors, Statutory Auditors and managers with key responsibilities |   |           |           |  |              |              |                             |            |            |
| • post-employment benefit plans  | 25  | 23        | 20        |  |              |              |                             |            |            |
| • remuneration to managers with key responsibilities   | 33  | 25        | 28        |  |              |              |                             |            |            |
|  | <b>58</b>   | <b>48</b> | <b>48</b> | <b>3,801</b>   | <b>4,142</b> | <b>3,852</b> | <b>1.5</b>                  | <b>1.2</b> | <b>1.2</b> |
| <b>Other operating expenses</b>  |   |           |           |  |              |              |                             |            |            |
| Of which related to transactions with:   |   |           |           |  |              |              |                             |            |            |
| • associates and joint- ventures   |   |           |           |  |              |              |                             |            |            |
| • subsidiaries of associates and joint- ventures   |   |           |           |  |              |              |                             |            |            |
| • other related parties through Directors, Statutory Auditors and managers with key responsibilities | 6   |           | 1         |  |              |              |                             |            |            |
| • post-employment benefit plans  |   |           |           |  |              |              |                             |            |            |
|  | <b>6</b>  |           | <b>1</b>  | <b>1,543</b>   | <b>1,468</b> | <b>1,603</b> | <b>0.4</b>                  |            | <b>0.1</b> |
| <b>Financial income</b>  |   |           |           |  |              |              |                             |            |            |
| Of which related to transactions with:   |   |           |           |  |              |              |                             |            |            |
| • associates and joint- ventures   | 1   | 2         | 5         |  |              |              |                             |            |            |
| • subsidiaries of associates and joint- ventures   |   |           |           |  |              |              |                             |            |            |
| • other related parties through Directors, Statutory Auditors and managers with key responsibilities |   |           |           |  |              |              |                             |            |            |
| • post-employment benefit plans  |   |           |           |  |              |              |                             |            |            |
|  | <b>1</b>  | <b>2</b>  | <b>5</b>  | <b>3,041</b>   | <b>3,144</b> | <b>2,205</b> | <b>0.0</b>                  | <b>0.1</b> | <b>0.2</b> |
| <b>Financial expenses</b>  |   |           |           |  |              |              |                             |            |            |
| Of which related to transactions with:   |   |           |           |  |              |              |                             |            |            |
| • associates and joint- ventures   | 27  | 32        | 60        |  |              |              |                             |            |            |
| • subsidiaries of associates and joint- ventures   |   |           |           |  |              |              |                             |            |            |
| • other related parties through Directors, Statutory Auditors and managers with key responsibilities |   |           |           |  |              |              |                             |            |            |
| • post-employment benefit plans  |   |           |           |  |              |              |                             |            |            |
|  | <b>27</b>   | <b>32</b> | <b>60</b> | <b>5,014</b>   | <b>5,131</b> | <b>4,197</b> | <b>0.5</b>                  | <b>0.6</b> | <b>1.4</b> |



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|  | Transactions with related parties in the years ended December 31, |            |            | Corresponding captions in consolidated financial statements as of December 31, |              |              | % impact of related parties |             |            |
|--|---|------------|------------|--|--------------|--------------|-----------------------------|-------------|------------|
|  | 2006  | 2005       | 2004       | 2006   | 2005         | 2004         | 2006                        | 2005        | 2004       |
|  | (millions of Euro)  |            |            |  |              |              |                             |             |            |
| <b>Capital expenditure for intangible and tangible assets on an accrual basis</b>                    |   |            |            |  |              |              |                             |             |            |
| Of which related to transactions with:   |   |            |            |  |              |              |                             |             |            |
| • associates and joint- ventures   | 144   | 147        | 71         |  |              |              |                             |             |            |
| • subsidiaries of associates and joint- ventures   | 338   | 319        | 324        |  |              |              |                             |             |            |
| • other related parties through Directors, Statutory Auditors and managers with key responsibilities | 61  | 69         | 24         |  |              |              |                             |             |            |
| • post-employment benefit plans  |   |            |            |  |              |              |                             |             |            |
|  | <b>543</b>  | <b>535</b> | <b>419</b> | <b>5,114</b>   | <b>5,173</b> | <b>5,002</b> | <b>10.6</b>                 | <b>10.3</b> | <b>8.4</b> |

**Dividends paid to third parties**

Of which related to transactions with:

|  |            |            |            |              |              |              |             |             |            |
|--|------------|------------|------------|--------------|--------------|--------------|-------------|-------------|------------|
| • associates and joint- ventures   |            |            |            |              |              |              |             |             |            |
| • subsidiaries of associates and joint- ventures   |            |            |            |              |              |              |             |             |            |
| • other related parties through Directors, Statutory Auditors and managers with key responsibilities | 348        | 264        | 140        |              |              |              |             |             |            |
| • post-employment benefit plans  |            | 6          | 1          |              |              |              |             |             |            |
|  | <b>348</b> | <b>270</b> | <b>141</b> | <b>2,997</b> | <b>2,328</b> | <b>2,780</b> | <b>11.6</b> | <b>11.6</b> | <b>5.1</b> |

|  | Balances with related parties as of December 31, |           | Corresponding captions in consolidated financial statements as of December 31, |            | % impact of related parties |            |
|--|--|-----------|--|------------|-----------------------------|------------|
|  | 2006   | 2005      | 2006   | 2005       | 2006                        | 2005       |
|  | (millions of Euro)                               |           |  |            |                             |            |
| <b>Securities, financial receivables and other non-current financial assets</b>                      |  |           |  |            |                             |            |
| Of which related to transactions with:   |  |           |  |            |                             |            |
| • associates and joint-ventures  | 24   | 24        |  |            |                             |            |
| • subsidiaries of associates and joint- ventures   |  |           |  |            |                             |            |
| • other related parties through Directors, Statutory Auditors and managers with key responsibilities |  |           |  |            |                             |            |
| • post-employment benefit plans  |  |           |  |            |                             |            |
|  | <b>24</b>  | <b>24</b> | <b>691</b>   | <b>996</b> | <b>3.5</b>                  | <b>2.4</b> |

**Securities, financial receivables and other non-current financial assets**

Of which related to transactions with:

**Securities (Current assets)**

Of which related to transactions with:

- *associates and joint- ventures*
- *subsidiaries of associates and joint- ventures*
- *other related parties through Directors, Statutory Auditors and Managers with key responsibilities*
- *post-employment benefit plans*

|  |     |     |
|--|-----|-----|
|  | 812 | 378 |
|--|-----|-----|

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- *subsidiaries of associates and joint- ventures*
- *other related parties through Directors, Statutory Auditors and Managers with key responsibilities*
- *post-employment benefit plans*

|            |            |               |               |            |            |
|------------|------------|---------------|---------------|------------|------------|
| <u>239</u> | <u>279</u> | <u>40,803</u> | <u>42,146</u> | <u>0.6</u> | <u>0.7</u> |
|------------|------------|---------------|---------------|------------|------------|

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|  | Financial Statements  |            | Notes To Consolidated Financial Statements |              |                 |            |
|--|-----------------------|------------|--|--------------|-----------------|------------|
|  | Balances with         |            | Corresponding captions                     |              | % impact of     |            |
|  | related parties as of |            | in consolidated financial                  |              | related parties |            |
|  | December 31,          |            | statements as of                           |              |                 |            |
| 2006   | 2005                  | 2006       | 2005                                       | 2006         | 2005            |            |
| (millions of Euro)   |                       |            |  |              |                 |            |
| <b>Current financial liabilities</b>   |                       |            |  |              |                 |            |
| Of which related to transactions with:   |                       |            |  |              |                 |            |
| • associates and joint-ventures  | 148                   | 124        |  |              |                 |            |
| • subsidiaries of associates and joint- ventures   |                       |            |  |              |                 |            |
| • other related parties through Directors, Statutory Auditors and Managers with key responsibilities |                       |            |  |              |                 |            |
| • post-employment benefit plans  |                       |            |  |              |                 |            |
|  | <u>148</u>            | <u>124</u> | <u>5,653</u>                               | <u>9,812</u> | <u>2.6</u>      | <u>1.3</u> |
| <b>Financial liabilities relating to discontinued operations/assets held for sale</b>                |                       |            |  |              |                 |            |
| Of which related to transactions with:   |                       |            |  |              |                 |            |
| • associates and joint-ventures  |                       |            |  |              |                 |            |
| • subsidiaries of associates and joint- ventures   |                       |            |  |              |                 |            |
| • other related parties through Directors, Statutory Auditors and Managers with key responsibilities |                       |            |  |              |                 |            |
| • post-employment benefit  |                       |            |  |              |                 |            |
|  |                       |            |  | <u>143</u>   |                 |            |
| <b>Miscellaneous receivables and other non-current assets</b>  |                       |            |  |              |                 |            |
| Of which related to transactions with:   |                       |            |  |              |                 |            |
| • associates and joint-ventures  | 10                    | 15         |  |              |                 |            |
| • subsidiaries of associates and joint- ventures   |                       |            |  |              |                 |            |
| • other related parties through Directors, Statutory Auditors and Managers with key responsibilities |                       |            |  |              |                 |            |
| • post-employment benefit  |                       |            |  |              |                 |            |
|  | <u>10</u>             | <u>15</u>  | <u>871</u>                                 | <u>825</u>   | <u>1.1</u>      | <u>1.8</u> |
| <b>Trade and miscellaneous receivables and other current assets</b>                                  |                       |            |  |              |                 |            |
| Of which related to transactions with:   |                       |            |  |              |                 |            |
| • associates and joint-ventures  | 201                   | 210        |  |              |                 |            |
| • subsidiaries of associates and joint- ventures   | 14                    | 12         |  |              |                 |            |
| • other related parties through Directors, Statutory Auditors and Managers with key responsibilities | 5                     | 6          |  |              |                 |            |
| • post-employment benefit  |                       |            |  |              |                 |            |
|  | <u>220</u>            | <u>228</u> | <u>8,748</u>                               | <u>8,856</u> | <u>2.5</u>      | <u>2.6</u> |



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| Balances with related parties as of December 31, |  | Corresponding captions in consolidated financial statements as of December 31, |      | % impact of related parties |  |
|--|--|--|------|-----------------------------|--|
|  |  | 2006   | 2005 |                             |  |

(millions of Euro)

**Miscellaneous payables and other non-current liabilities**

Of which related to transactions with:

|  |           |           |              |              |                |
|--|-----------|-----------|--------------|--------------|----------------|
| • associates and joint- ventures   |           |           |              |              |                |
| • subsidiaries of associates and joint- ventures   | 23        | 10        |              |              |                |
| • other related parties through Directors, Statutory Auditors and Managers with key responsibilities |           |           |              |              |                |
| • post-employment benefit  |           |           |              |              |                |
|  | <b>23</b> | <b>10</b> | <b>1,857</b> | <b>2,113</b> | <b>1.2 0.5</b> |

**Trade and miscellaneous payables and other current liabilities**

Of which related to transactions with:

|  |            |            |               |               |                |
|--|------------|------------|---------------|---------------|----------------|
| • associates and joint- ventures   | 99         | 116        |               |               |                |
| • subsidiaries of associates and joint- ventures   | 58         | 103        |               |               |                |
| • other related parties through Directors, Statutory Auditors and Managers with key responsibilities | 27         | 43         |               |               |                |
| • post-employment benefit  | 20         | 19         |               |               |                |
|  | <b>204</b> | <b>281</b> | <b>11,596</b> | <b>12,157</b> | <b>1.8 2.3</b> |

The economic and financial effects of transactions with related parties on the consolidated financial statements of the Telecom Italia Group as of December 31, 2006 and 2005 and for the years ended December 31, 2006, 2005 and 2004 are presented below.

The following tables present the major economic, balance sheet and financial items and related transactions between companies consolidated line-by-line on one hand and associates and joint ventures on the other.

**Transactions with related parties in the years ended December 31,**

| Items    | 2006             |  | 2005             |  | 2004             |  |
|----------|------------------|--|------------------|--|------------------|--|
|          | In the aggregate | Main transactions  | In the aggregate | Main transactions  | In the aggregate | Main transactions  |
| Revenues | 270 million      | These mainly refer to revenues from Teleleasing S.p.A. 225 million, LI.SIT. S.p.A. | 336 million      | These mainly refer to revenues from Teleleasing S.p.A. 230 million, LI.SIT. S.p.A. | 310 million      | These mainly refer to revenues from Teleleasing S.p.A. 200 million, LI.SIT. S.p.A. |

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12 million, Shared  
Service Center Srl 20  
million, ETECSA 8  
million, AVEA I.H.A.S.  
1 million, Nordcom  
S.p.A. 1 million and  
Siemens Informatica  
S.p.A. 1 million.

68 million, Shared  
Service Center S.c.r.l.  
22 million, Golden  
Lines Ltd 3 million,  
ETECSA 6 million,  
AVEA I.H.A.S. 2  
million and NordCom  
S.p.A. 2 million.

50 million, Shared  
Service Center S.c.r.l.  
32 million, Golden  
Lines Ltd 10 million,  
ETECSA 9 million,  
AVEA I.H.A.S.  
1 million.

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|---|---|---|--|---|------------------|---|
|   | Transactions with related parties in the years ended December 31, |   |  |   |                  |   |
|   | 2006  |   | 2005                                       |   | 2004             |   |
| Items   | In the aggregate  | Main transactions   | In the aggregate                           | Main transactions   | In the aggregate | Main transactions   |
| <i>Other income</i>                                 | 6 million   | This mainly refers to cost recoveries for off-site personnel by certain subsidiaries and associates.  | 6 million                                  | This mainly refers to cost recoveries for off-site personnel by certain subsidiaries and associates.  | 5 million        | This mainly refers to cost recoveries for off-site personnel by certain subsidiaries and associates.  |
| <i>Purchases of materials and external services</i> | 103 million   | These refer mainly to costs for rent from Tiglio I S.r.l. 5 million, Tiglio II S.r.l. 3 million, for TLC services from ETECSA 6 million, AVEA I.H.A.S. 2 million, for maintenance and assistance contracts from Shared Service Center Scrl 27 million, for software and computer materials and for maintenance and assistance contracts from Siemens Informatica S.p.A. 17 million, for TLC equipment from Teleleasing S.p.A. 15 million, for sponsorship costs from Luna Rossa Challenge 2007 S.L. 17 million, for accessories and consumables from Baltea S.r.l. 4 million, for remote medicine services from Telbios S.p.A. 5 million and for software services from Nordcom S.p.A. 2 million. | 266 million                                | These refer mainly to costs for rent from Tiglio I S.r.l. 10 million, Tiglio II S.r.l. 12 million, for TLC services from ETECSA 90 million, AVEA I.H.A.S. 3 million, for maintenance and assistance contracts from Shared Service Center S.c.r.l. 34 million, for software and computer materials and for maintenance and assistance contracts from Siemens Informatica S.p.A. 52 million, for TLC equipment from Teleleasing S.p.A. 23 million, sponsorship costs from Luna Rossa Challenge 2007 S.L. 17 million, costs for accessories and consumables from Baltea S.r.l. 3 million, costs for remote medicine services from Telbios S.p.A. 3 million, cost for software services from Nordcom S.p.A. 1 million and transport costs from Eurofly Service S.p.A. 3 | 403 million      | These refer mainly to costs for rent from Tiglio I S.r.l. 50 million, Tiglio II S.r.l. 26 million, for TLC services from ETECSA 123 million, for maintenance and assistance contracts from Shared Service Center S.c.r.l. 106 million, for software and computer materials and for maintenance and assistance contracts from Siemens Informatica S.p.A. 63 million, for TLC equipment from Teleleasing S.p.A. 15 million, costs for accessories and consumables from Baltea S.r.l. 4 million and costs for remote medicine services from Telbios S.p.A. 1 million, Telegono S.r.l. 1 million and AVEA I.H.A.S. 1 million. |

million.

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| Items   | 2006                    |   | 2005  |  | 2004   |   |
|---|-------------------------|---|---|--|--|---|
|   | In the aggregate        | Main transactions   | In the aggregate  | Main transactions  | In the aggregate   | Main transactions   |
|   | <i>Financial income</i> | 1 million   | This includes accrued interest income earned on loans granted to certain associates | 2 million  | This includes accrued interest income earned on loans granted to certain associates. | 5 million   |
| <i>Financial expenses</i>   | 27 million              | These mainly refer to (i) interest expenses to Teleleasing S.p.A. 26 million for finance leases and (ii) interest expenses to Tiglio I S.r.l. 1 million.                    | 32 million  | These mainly refer to interest expenses to Teleleasing S.p.A. 23 million, for finance leases and interest expenses to Tiglio I S.r.l. 4 million and Tiglio II S.r.l. 4 million, for sale and leaseback transactions. | 60 million   | These mainly refer to interest expenses to Teleleasing S.p.A. 20 million, for finance leases and interest expenses to Tiglio I S.r.l. 29 million and Tiglio II S.r.l. 10 million for sale and leaseback transactions. |
| <i>Capital expenditures in tangible and intangible assets (on an accrual basis)</i> | 144 million             | These refer mainly to acquisitions of computer projects from Shared Service Center S.c.r.l. 77 million, Siemens Informatica S.p.A. 65 million and Telbios S.p.A. 1 million. | 147 million   | These refer mainly to acquisitions of computer projects from Shared Service Center S.c.r.l. 84 million, Siemens Informatica S.p.A. 42 million, Telbios S.p.A. 1 million and Value Team S.p.A. 8 million.             | 71 million   | These refer mainly to acquisitions of computer projects from Shared Service Center S.c.r.l. 21 million, Siemens Informatica S.p.A. 50 million.  |

**Balances with related parties as of December 31,**

| Items | 2006  |                   | 2005             |                   |
|-------|---|-------------------|------------------|-------------------|
|       | In the aggregate  | Main transactions | In the aggregate | Main transactions |
|       | <i>Securities, financial receivables and other non-current financial assets</i> |                   |                  |                   |

|   |            |  |            |  |
|---|------------|--|------------|--|
|   | 24 million | These refer to medium/long-term loans grants to Aree Urbane S.r.l. 24 million.                             | 24 million | These refer mainly to medium/long term loans grants to Aree Urbane S.r.l. 21 million and Tiglio II S.r.l. 3 million. |
| <i>Miscellaneous receivables and other non-current assets</i> |            |  |            |  |
|   | 10 million | These refer to receivables from LI.SIT S.p.A. 10 million for the residual additional paid-in capital paid. | 15 million | These refer to receivables from LI.SIT S.p.A. 15 million for the residual additional paid-in capital paid.           |

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|   | Financial Statements                             |  | Notes To Consolidated Financial Statements |   |
|---|--|--|--|---|
|   | Balances with related parties as of December 31, |  |  |   |
|   | 2006   |  | 2005                                       |   |
| Items   | In the aggregate                                 | Main transactions  | In the aggregate                           | Main transactions   |
| <i>Trade and miscellaneous receivables and other current assets</i> | 201 million                                      | These refer mainly to receivables from LI.SIT. S.p.A. 120 million, Teleleasing S.p.A. 64 million, Luna Rossa Challenge 2007 S.L. 10 million, Shared Service Center S.c.r.l. 2 million, ETECSA 2 million, Telbios S.p.A. 1 million and Im.Ser S.r.l. 1 million. | 210 million                                | These refer mainly to receivables from LI.SIT. S.p.A. 109 million, Teleleasing S.p.A. 75 million, Luna Rossa Challenge 2007 S.L. 4 million, Shared Service Center S.c.r.l. 4 million, ETECSA 3 million, Telbios S.p.A. 1 million and Im.Ser S.r.l. 1 million. At December 31, 2005, there were also receivables from Avea IHAS 8 million, Tiglio II S.r.l. 3 million, NordCom S.p.A. 1 million and Tiglio I S.r.l. 1 million. |
| <i>Financial receivables and other current financial assets</i>     | 1 million  | These refer to loans made to Aree Urbane S.r.l..   |  |   |
| <i>Cash and cash equivalents</i>                                    | 1 million  | These refer to treasury accounts with associates.  | 14 million                                 | These refer to treasury accounts with associates.   |
| <i>Non-current financial liabilities</i>                            | 239 million                                      | These refer to non-current financial payables for finance leases (i) to Teleleasing S.p.A. 231 million and (ii) for sale and leaseback real estate transactions to Tiglio I S.r.l. 7 million and Tiglio II S.r.l. 1 million.                                   | 279 million                                | These refer to non-current financial payables for finance leases to Teleleasing S.p.A. 203 million, for sale and leaseback real estate transactions to Tiglio I S.r.l. 43 million and Tiglio II S.r.l. 33 million.  |

|                                      |             |   |             |   |
|--------------------------------------|-------------|---|-------------|---|
| <i>Current financial liabilities</i> |             |   |             |   |
|                                      | 148 million | These refer to current financial payables for finance leases (i) to Teleleasing S.p.A. 143 million and (ii) for sale and leaseback real estate transactions Tiglio I S.r.l. 4 million and Tiglio II S.r.l. 1 million. | 124 million | These refer to current financial payables for finance leases (i) to Teleleasing S.p.A. 113 million, (ii) for sale and leaseback real estate transactions to Tiglio I S.r.l. 8 million and Tiglio II S.r.l. 3 million. |



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| <b>Items</b>  | <b>2006</b>             |  | <b>2005</b>             |  |
|---|-------------------------|--|-------------------------|--|
|   | <b>In the aggregate</b> | <b>Main transactions</b>   | <b>In the aggregate</b> | <b>Main transactions</b>   |
| <i>Trade and miscellaneous payables and other current liabilities</i> | 99 million              | These mainly refer to payables, for supply transactions connected with operating and investment activities, to Siemens Informatica S.p.A. 48 million, Shared Service Center S.c.r.l. 16 million, LI.SIT S.p.A. 14 million mainly regarding accruals relating to the portion of deferred income from investments, Teleleasing S.p.A. 3 million, ETECSA 12 million, Telbios S.p.A. 2 million, Baltea S.r.l. 1 million, Luna Rossa Challenge 2007 S.L. 1 million, Asscom S.r.l. 1 million and NordCom S.p.A. 1 million. | 116 million             | These mainly refer to payables, for supply transactions connected with operating and investing activities with Siemens Informatica S.p.A. 56 million, Shared Service Center S.c.r.l. 18 million, LI.SIT S.p.A. principally for the portion of deferred income from equity investments 11 million, Teleleasing S.p.A. 8 million, ETECSA 11 million, Tiglio I S.r.l. 2 million, Tiglio II S.r.l. 4 million, Telbios S.p.A. 2 million, Baltea S.r.l. 1 million and AVEA I.H.A.S. 1 million. |

The Telecom Italia Group has also provided guarantees on behalf of associates for a total of 102 million ( 276 million at December 31, 2005) of which 54 million is on behalf of Tiglio I S.r.l. ( 54 million at December 31, 2005), 11 million on behalf of Aree Urbane S.r.l. ( 44 million at December 31, 2005), 25 million on behalf of Italtel Group ( 31 million at December 31, 2005) and 12 million on behalf of other companies ( 13 million at December 31, 2005). At December 31, 2005, there were guarantees provided on behalf of AVEA I.H.A.S. for 121 million and on behalf of Tiglio II S.r.l. for 13 million.

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The following table presents the major economic, balance sheet and financial items and related transactions between companies consolidated line-by-line on one hand and companies controlled by associates and by joint-ventures on the other (the companies of the Italtel group, a related party through the investment in the parent Italtel group S.p.A. and the companies of the Telecom Argentina group related through Sofora Telecomunicaciones S.A.). The companies of the Brasil Telecom Participações S.A. group are considered related parties through Solpart Participações S.A. from July 1, 2005 to October 1, 2006 since the investment in Solpart Participações S.A. was transferred in October 2006 to Brasilco S.r.l., a newly-established Italian company held by a trust registered under British law of which Telecom Italia International is the beneficiary. This is described in greater detail in the Note 8 Other non-current assets .

**Transactions with related parties in the years ended December 31,**

| Items   | 2006             |  | 2005             |  | 2004             |  |
|---|------------------|--|------------------|--|------------------|--|
|   | In the aggregate | Main transactions  | In the aggregate | Main transactions  | In the aggregate | Main transactions  |
| <i>Revenues</i>                                     | 176 million      | These refer to revenues for telecommunications services from the Brasil Telecom Participações group 158 million, the Telecom Argentina group 16 million and the Italtel group 2 million.   | 104 million      | These refer to revenues for telecommunications services from the Brasil Telecom Participações group 89 million, the Telecom Argentina group 12 million and the Italtel group 3 million.  | 13 million       | These mainly refer to revenues for telecommunications services rendered to the Telecom Argentina group 10 million.                     |
| <i>Other income</i>                                 | 1 million        | This mainly refers to cost recoveries for off-site personnel by certain subsidiaries and associates.   |                  |  |                  |  |
| <i>Purchases of materials and external services</i> | 61 million       | These refer (i) to costs for maintenance and assistance contracts from the Italtel group 25 million; (ii) TLC service costs from the Brasil Telecom Participações group 29 million and from the Telecom Argentina group 7 million. | 36 million       | These refer (i) to costs for maintenance and assistance contracts from the Italtel group 20 million; (ii) TLC service costs from the Brasil Telecom Participações group 10 million and from the Telecom Argentina group 6 million. | 29 million       | These refer to costs for maintenance and assistance contracts from the Italtel group 23 million and Telecom Argentina group 6 million. |

*Capital expenditures in tangible and intangible assets (on an accrual basis)*

338 million These refer to the purchase of telephone exchanges from the Italtel group.

319 million These refer to the purchase of telephone exchanges from the Italtel group.

324 million These refer to the purchase of telephone exchanges from the Italtel group.

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|   | Financial Statements                             |   | Notes To Consolidated Financial Statements |  |
|---|--|---|--|--|
|   | Balances with related parties as of December 31, |   |  |  |
|   | 2006   |   | 2005                                       |  |
| Items   | In the aggregate                                 | Main transactions   | In the aggregate                           | Main transactions  |
| <i>Trade and miscellaneous receivables and other current assets</i>   | 14 million                                       | These refer to telephone services to the Italtel group 1 million and receivables from the Telecom Argentina group connected with TLC activities for 13 million.   | 12 million                                 | These refer to telephone services to the Italtel group 2 million and receivables from the Telecom Argentina group connected with TLC activities for 4 million. At December 31, 2005, there were also receivables of 6 million from the Brasil Telecom Participações group. |
| <i>Miscellaneous payables and other non-current liabilities</i>       | 23 million                                       | These refer to the medium/long-term portion of the deferral relating to the supply of IRU transmission capacity to Telecom Argentina S.A..  | 10 million                                 | These refer to the medium/long-term portion of the deferral relating to the supply of IRU transmission capacity to Telecom Argentina S.A..   |
| <i>Trade and miscellaneous payables and other current liabilities</i> | 58 million                                       | These refer to payables, for the supply transactions connected with investment and operating activities, to the Italtel group 54 million and to the Telecom Argentina group for TLC activities 4 million of which 2 million represent the short-term portion of the deferral relating to the supply of IRU transmission capacity to Telecom Argentina S.A.. | 103 million                                | These refer to payables, for the supply transactions connected with investing and operating activities to Italtel group for 100 million and to the Telecom Argentina group for TLC activities for 2 million.   |



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The following table presents the major economic and financial transactions between companies consolidated line-by-line on one hand and parties related to the Telecom Italia S.p.A. through directors, statutory auditors and managers of the company with key responsibilities on the other.

**Transactions with related parties in the years ended December 31,**

| Items   | 2006             |  | 2005             |   | 2004             |   |
|---|------------------|--|------------------|---|------------------|---|
|   | In the aggregate | Main transactions  | In the aggregate | Main transactions   | In the aggregate | Main transactions   |
| <i>Revenues</i>                                     | 18 million       | These refer to (i) IT and energy services supplied to the Pirelli group 3 million; (ii) telephone services supplied to the Pirelli group 8 million, to the Edizione Holding group 5 million, to Telepost 1 million and to related companies through Mr. Moratti 1 million. | 33 million       | These refer to (i) IT and energy services supplied to the Pirelli group 3 million; (ii) telephone services supplied to the Pirelli group 7 million, to the Edizione Holding group 4 million, to Telepost 1 million and to related companies through Mr. Moratti 2 million. In 2005, they included 16 million to the Unipol Group and 1 million to STMicroelectronics which are no longer related parties in 2006. | 40 million       | These refer to (i) IT and energy services supplied to the Pirelli group 5 million, and (ii) telephone services supplied to the Pirelli group 3 million, to the Edizione Holding group 5 million, to the Unipol group 13 million, to the STMicroelectronics group 2 million and to related companies through Mr. Moratti 1 million. In 2004, they included 11 million of revenues from the Banca Intesa group and the Unicredito group which are no longer related parties in 2006 and 2005. |
| <i>Purchases of materials and external services</i> | 93 million       | These refer to R&D expenditures, purchases of modems and ADSL equipment, consulting and services regarding industrial property and real estate activities from the Pirelli group, 69 million, Document Management services from Telepost 18 million, sponsorship           | 112 million      | These refer to R&D expenditures, purchases of modems and ADSL equipment, consulting and services regarding industrial property and real estate activities from the Pirelli group, 72 million, Document Management services from Telepost 21 million, sponsorship  | 120 million      | These refer to R&D expenditures and matters regarding intellectual property rights from the Pirelli group 86 million, Document management services from Telepost 15 million, insurance services from the Unipol group 11 million, sponsorship and   |

and content provider costs from F.C. Internazionale Milano S.p.A. a related company through Mr. Moratti, 3 million, commissions paid to Autogrill S.p.A (Edizione Holding group) for the sale of prepaid telephone cards 2 million and the supply of gas by Camfin 1 million.

and content provider costs from F.C. Internazionale Milano S.p.A. a related company through Mr. Moratti, 5 million, commissions paid to Autogrill S.p.A (Edizione Holding group) for the sale of prepaid telephone cards 2 million. In 2005, they included 10 million relating to insurance services from the Unipol group and 2 million from STMicroelectronics, which are no longer related parties in 2006.

content provider costs from F.C. Internazionale Milano S.p.A., a related company through Mr. Moratti 5 million, commissions paid to Autogrill S.p.A (Edizione Holding group) for the sale of prepaid telephone cards 2 million and the purchase of electronic components from STMicroelectronics 1 million.

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| Items   | 2006                |  | 2005             |   | 2004             |  |
|---|---------------------|--|------------------|---|------------------|--|
|   | In the aggregate    | Main transactions  | In the aggregate | Main transactions   | In the aggregate | Main transactions  |
|   | <i>Other income</i> |  |                  |   |                  | 1 million  |
| <i>Other operating expenses</i>   | 6 million           | These refer to commercial settlements with the Pirelli group.                                |                  |   | 1 million        | These refer to miscellaneous expenses with the Pirelli group.                                    |
| <i>Capital expenditures in tangible and intangible assets (on an accrual basis)</i> | 61 million          | These mainly refer to purchases of modems, cables and ADSL equipment from the Pirelli group. | 69 million       | These refer to purchases of cables, modems and ADSL equipment from the Pirelli group. | 24 million       | These refer to purchases of cables, modems and ADSL equipment from the Pirelli group 24 million. |

**Balances with related parties as of December 31,**

| Items | 2006  |                   | 2005  |                   |
|-------|---|-------------------|---|-------------------|
|       | In the aggregate  | Main transactions | In the aggregate  | Main transactions |
|       | <i>Trade and miscellaneous receivables and other current assets</i> | 5 million         | These mainly refer to the above-mentioned services under revenues with the Pirelli group 3 million, the Edizione Holding group 1 million and other companies 1 million. | 6 million         |



*Trade and miscellaneous payables and other current liabilities*

27 million These mainly refer to supply transactions connected both to the purchases and the performance of services both to the investing activities, to the Pirelli group 20 million, to Telepost for Document Management services 4 million, to F.C. Internazionale Milano S.p.A. a related company through Mr. Moratti, for sponsorship and content provider costs 2 million.

43 million These mainly refer to supply transactions connected to the performance of services and investing activities with the Pirelli group 34 million, costs for Document Management services from Telepost 7 million. In 2005 they included 1 million of payables to STMicroelectronics, which is no longer a related party in 2006.

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The following table presents the major economic, balance sheet and financial items and related transactions between companies consolidated line-by-line on one hand and pension plans of the companies of the Telecom Italia Group on the other.

**Transactions with related parties in the years ended December 31,**

| Items | 2006                   |                   | 2005  |                   | 2004  |                   |
|-------|------------------------|-------------------|---|-------------------|---|-------------------|
|       | In the aggregate       | Main transactions | In the aggregate  | Main transactions | In the aggregate  | Main transactions |
|       | <i>Personnel costs</i> | 25 million        | These refer to the contribution made to pension funds of which 17 million for Telemaco, 6 million for Fontedir and 2 million for other Italian and foreign pension funds. | 23 million        | These refer to the contribution made to pension funds of which 16 million for Telemaco, 5 million for Fontedir and 1 million for other Italian and foreign pension funds. | 20 million        |

**Balances with related parties as of December 31,**

| Items | 2006  |                   | 2005  |                   |
|-------|---|-------------------|---|-------------------|
|       | In the aggregate  | Main transactions | In the aggregate  | Main transactions |
|       | <i>Trade and miscellaneous payables and other current liabilities</i> | 20 million        | These refer to contributions payable to pension funds of which 15 million for Telemaco, 4 million for Fontedir and 1 million for other Italian and foreign pension funds. | 19 million        |

The following is a brief description of the contents of the main contracts between the Telecom Italia Group on one hand and companies controlled by associates or by joint ventures and related parties through directors, statutory auditors and managers with key responsibilities on the other.

**Contracts with:**

*Avea I.H.A.S.*

Revenue related

The contracts refer to international telecommunications services, particularly roaming by Avea customers on the Telecom Italia network, technical assistance services rendered and cost recoveries for off-site personnel of Telecom Italia at Avea.

Expense related

The contracts refer to interconnection fees for roaming traffic by Telecom Italia customers on the Avea network.

*Baltea S.p.A*

Expense related

The contracts refer to purchases of accessories and consumable stores for Olivetti S.p.A. photocopiers destined for resale.

*ETECSA*

Revenue related

The main contracts relate to:

- Telecom Italia Sparkle data traffic;

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- technical assistance supplied by Telecom Italia S.p.A.;
- recovery of costs for off-site personnel.

Expense related

The main contracts relate to roaming traffic originated by Telecom Italia customers on the ETECSA network.

*IN.VA S.p.A.*

Revenue related

The main contracts refer to the supply of telephone and data transmission services.

*LI.SIT S.p.A.*

Revenue related

The contract provides for developing and implementing the computer and information network for the social health system of the Lombardy Region, making services available online to all the regional health structures by supplying:

- cards with microchips for all citizens and health operators in Lombardy;
- outsourcing services for the management of the Internet Data Center and hardware and software systems;
- professional and applications consulting for the implementation and management of the system.

*Luna Rossa Challenge 2007 S.L.*

Revenue related

The main contracts cover the supply of telephone and data transmission services.

Expense related

The main contracts refer to the sponsorship of the Luna Rossa sailboat during the XXXII America's Cup. According to these contracts, Telecom Italia Group became the Main Sponsor of Luna Rossa and Partner and Official Sponsor of the race. It also acquired the sublicense rights on the Luna Rossa trademark for certain categories of goods.

*Nordcom S.p.A.*

Revenue related

The main contracts refer to the supply of data network connections and software applications.

Expense related

The contract refers to the development of systems and computer solutions.

*Shared Service Center S.c.a.r.l.*

Revenue related

The main contracts refer to:

- the supply of telephone and data transmission services;
- the operation of the client's software applications at the Telecom Italia S.p.A. data center;
- the recovery of costs of off-site personnel and centralized expenses (management fee and convention expenses).



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Expense related

The main contracts refer to the supply of computer and information services relating to:

- design, implementation, release, operation and management of portals, institutional sites, SAP and dedicated solutions;
- SAP application maintenance and service management services.

*Siemens Informatica S.p.A.*

Expense related

The main contracts cover:

- the supply of software services to Group companies;
- Applications Management services;
- support services for the operation of Telecom Italia S.p.A. OSS and BSS systems;
- the supply of support services for distributed computer technology;
- applications software development and technical services for Telecom Italia S.p.A..

*Teleleasing S.p.A.*

Revenue related

The contracts relate to the application of the commercial cooperation agreement signed in 2000. By virtue of this agreement, Telecom Italia S.p.A. is committed to guaranteeing Teleleasing the role of preferential partner in the case of the purchase of goods

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under finance leases by its customers. Teleleasing S.p.A. purchases the equipment from Telecom Italia S.p.A. and signs the leasing contract with the customer; Telecom Italia S.p.A. sees to the collection of lease payments after having acquired the rights.

Expense related

The contracts refer both to the finance lease of telephone systems to Telecom Italia S.p.A. and its subsidiaries and the finance lease of a building.

*Telbios S.p.A.*

Revenue related

The main contracts cover the supply of telephone services and services for WBS activities.

Expense related

The main contracts refer to the supply of services, products and hardware systems and software for the remote medicine offering.

*Tiglio I S.r.l.*

Revenue related

The main contracts call for the supply of telephone services.

Expense related

The main contracts refer to:

- the lease of buildings (also premises housing telecommunications equipment) with a term of 21 years and the possibility of tacit renewal, unless notice of termination is given by Telecom Italia S.p.A., for successive periods of 6 years, at the same terms and conditions as originally agreed;



- the lease of buildings solely for office use, for standard lease periods.

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*Tiglio II S.r.l.*

Expense related

The main contracts refer to:

- the lease of buildings (also premises housing telecommunications equipment) with a term of 19 years and the possibility of tacit renewal, unless notice of termination is given, by Telecom Italia S.p.A. for successive periods of 6 years, at the same terms and conditions as originally agreed;
- the lease of buildings solely for office use, for standard lease periods.

\* \* \*

*Brasil Telecom Participações group*

Revenue related

The contracts refer to telecommunications services, interconnection services in particular, and site sharing.

Expense related

These refer to telecommunications services, interconnection services in particular, site sharing and line leases.

*Telecom Argentina group*

Revenue related

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The main contracts refer to technical assistance provided by Telecom Italia S.p.A. for broadband development and for the study and implementation of Value Added Services, as well as data transmission and voice services and the supply of IRU transmission capacity by Telecom Italia Sparkle.

Expense related

The contracts relate to international telecommunications services and roaming.

*Italtel Group*

Revenue related

The main contracts provide for the supply of telephone and data transmission services.

Expense related

The main contracts provide for the supply and maintenance of traditional switching and innovative switching (VoIP) equipment and the relative services, as well as the supply of innovative devices and their maintenance for the data networks using CISCO technology.

\* \* \*

*Camfin S.p.A.*

Revenue related

The main contracts refer to the supply of telephone and data transmission services.

Expense related

The contract refers to the supply of gas with the company Cam Gas S.p.A..

*Edizione Holding group*

Revenue related

The main contracts provide for the supply of telephone and data transmission services that are operated by outsourcing with dedicated assistance.

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Expense related

The main contracts refer to commissions paid to Autogrill S.p.A. for the sale of prepaid telephone cards and occupancy charges for public telephones located at their structures.

*F.C. Internazionale Milano S.p.A.*

Revenue related

The main contracts call for the supply of telephone and data transmission services.

Expense related

The main contracts refer to costs for the sponsorship and the rights to diffuse content regarding the sports events of the company F.C. Internazionale Milano (Inter) by Telecom Italia S.p.A.. The sponsorship contract particularly provides for the possibility of using the Inter brand and logo for all advertising activities and the sale of mobile telephone products, the participation of Inter in the Trofeo TIM and the visibility of the TIM brand during the Inter championship and Coppa Italia/TIM Cup games at home.

*Pirelli & C. S.p.A.*

Revenue related

The main contracts provide for the supply of telecommunications and computer and information services.

Expense related

The main contracts refer to:

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- consulting and services contract regarding patent rights;
- defining strategies regarding patent rights;
- determination of the competitive positioning of the various businesses of the Telecom Italia Group in comparison with similar business of the competition;
- assistance in negotiations over partnerships, licenses and cooperation contracts;
- litigation and analyses of patents of the competition;
- obtaining patents (drawing up documents, filings in Italy and outside Italy, continuation during the stages of examination, challenges and conflicts);
- control over costs by project and/or by business;
- training of technicians;
- management of a database for patent data and relative reports;
- control over results reached;
- patent researches;
- filing and classification of important documents regarding patents;
- brands, including their management (research, filings in Italy and outside Italy, renewals, challenges, disputes, licenses inside and outside the Group);
- technical cooperation between Telecom Italia S.p.A. and Pirelli in the areas of optical devices and advanced telecommunications networks. The contract provides:
  1. with regard to the results of research for which patents are not filed, three areas of competence which have been identified as follows:
    - simple and complex devices, competence of Pirelli;
    - networks and services, competence of Telecom Italia S.p.A.;
    - subsystems, joint competence of Telecom Italia S.p.A. Pirelli;



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2. with regard to patents resulting from research, ownership is joint, with the understanding that each party must give the other a license on the respective portion of ownership according to the following format:

Pirelli grants Telecom Italia S.p.A. an exclusive license which can be sublicensed for patents for use in the Networks and Services area;

Telecom Italia S.p.A. grants Pirelli an exclusive license which can be sublicensed for patents for use in the Devices area; each of the parties is required to pay the other party 50% of the consideration from any sublicenses granted.

Furthermore, Pirelli is obliged to sell, under an exclusive arrangement, any optical devices for telecommunications that use patents deriving from the research projects, for a period of one year from the completion of the single project. However, the parties may agree upon alternative solutions which ensure a similar or substitute advantage to Telecom Italia S.p.A.;

- supply of user apparatus for network access and broadband services;
  
- cooperation agreement concerning joint initiatives. Under this contract, Pirelli has developed two research projects for Telecom Italia S.p.A.: one relating to the Distributed Sensor Network and the second to Third-generation poles for the wireline network. The agreements state that Telecom Italia S.p.A. is entitled to ownership of the rights to the intellectual properties deriving from the work established in the contracts where they are:
  - a) exclusively applicable to telecommunications networks and/or telecommunications services or components of telecommunications networks which technical appendices of the projects identify as their specific objective, such as cards of the SIM-card type or network poles, and
  - b) characterized by the inclusion of specific chemical compositions and/or treatments using specific chemical processes.

*Pirelli & C. Real Estate S.p.A.*

Revenue related

The contracts provide for the supply of call center services, data transmission services and electrical energy.

Expense related



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The contracts refer to project management (development of real estate projects), property management (administrative management of lease contracts) and agency services (commercial management of owned and leased buildings) and maintenance of air-conditioning systems.

Furthermore, Pirelli & C. Real Estate has a 35% stake in the capital of the companies which hold the closed-end real estate investment funds Raissa and Spazio Industriale (to which properties were contributed as part of the real estate transaction approved by the board of directors on December 21, 2005) and hold control of the management companies (Pirelli & C. Real Estate SGR and Pirelli & C. Real Estate SGR Opportunities) of the above real estate funds.

*Telepost S.p.A.*

Revenue related

The main contracts call for the supply of telephone services.

Expense related

The main contracts refer to:

- the management of services connected with incoming and outgoing correspondence;
- the management of outgoing correspondence generated on files with printing by a specialized center;
- management of the distribution of correspondence;
- management of the paper archives and management of all photocopy machines.

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Expense related

The payables mainly refer to Telemaco and Fontedir for:

- payment of contributions by both Telecom Italia S.p.A. and the employee;
- supply of personal information records of the associated employees by Telecom Italia S.p.A..

For the other minor funds (BYBLOS, LABORFOND, etc.), the payables refer to payments made for contributions.

\* \* \*

**Remuneration to managers with key responsibilities**

Key managers , that is, those persons having authority and responsibility, directly or indirectly, for planning, management and control of the activities of Telecom Italia, including directors, are as follows:

| <b>Name</b>                  | <b>Position</b>   |
|------------------------------|---|
| <b>Directors:</b>            |   |
| Marco Tronchetti Provera (*) | Chairman  |
| Guido Rossi (**)             | Chairman  |
| Carlo Orazio Buora           | Chief Executive Officer   |
| Riccardo Ruggiero            | Executive Deputy Chairman as from September 15, 2006<br>Chief Executive Officer |
|                              | General Manager   |
| <b>Managers:</b>             |   |
| Gustavo Bracco               | Head of Group Human Resources, Organization and Security Function               |
| Enrico Parazzini             | Head of Group Finance, Administration and Control Function                      |
|                              | Head of Media Business Unit   |

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|   |  |
|---|--|
| Massimo Castelli<br>Fancesco Chiappetta     | Chief Executive Officer of Telecom Italia Media S.p.A.<br>Head of Market Development in Operations<br>General Counsel    |
| Luca Luciani<br>Giuseppe Sala (***)         | Head of Group Corporate and Legal Affairs Function<br>Head of Sales & Customer Services in Operations<br>General Manager |
| Stefano Pileri                              | Head of Top Client and Customer Services in Operations<br>Chief Technology Officer                                       |
| Ramon Grijuela (****)<br>Germanio Spreafico | Head of Technology in Operations<br>Head of Top Clients in Operations<br>Head of Purchasing                              |

(\*) Up to September 15, 2006.

(\*\*) From September 16, 2006.

(\*\*\*) Up to May 31, 2006.

(\*\*\*\*) From September 11, 2006.

The total compensation recorded on the accrual basis by Telecom Italia S.p.A. or by companies controlled by the Group in respect of managers with key responsibilities amounted to 33 million ( 25 million in 2005), divided as follows :

|   | Year ended<br>December 31, |           |
|---|----------------------------|-----------|
|   | 2006                       | 2005      |
|   | (millions of Euro)         |           |
| Short-term compensation                   | (*)19                      | (*)23     |
| Long-term compensation                    | 4                          | 2         |
| Employment termination benefit incentives | 10                         |           |
|   | <b>33</b>                  | <b>25</b> |

(\*) Of which 0.3 million paid by the subsidiary TI Media S.p.A..

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**NOTE 42 STOCK OPTION PLANS OF THE TELECOM ITALIA GROUP**

At December 31, 2006, the existing stock option plans relate to options that give the right to the subscription of Telecom Italia Ordinary Shares (including the options granted at the time by TIM S.p.A.) and Telecom Italia Media Ordinary Shares.

During 2006, no new stock option plans were introduced; options were last granted in 2005 and referred to the Stock Option Plan Telecom Italia Media S.p.A..

The stock option plans of the Group are described below.

***Telecom Italia S.p.A. Stock Option Plans***

With respect to the Telecom Italia stock option plans, account should be taken of the mergers that previously took place and which are described below:

- merger of Telecom Italia S.p.A. into Olivetti S.p.A.: starting from the date the merger came into effect (August 4, 2003), the holders of the options of the merged company and the merging company preserved the corresponding subscription rights. However, the number of shares that could originally be subscribed under the respective plans (one share for each option) was changed on the basis of the assignment ratio established for the shareholders of the two companies. In particular, each option of the pre-merger Telecom Italia S.p.A. stock option plans allows the subscription of 3.300871 new Telecom Italia Ordinary Shares post-merger, whereas each option of the Olivetti S.p.A. stock option plans, now all ended, allowed the subscription of 0.471553 new Telecom Italia S.p.A. Ordinary Shares post-merger. Accordingly, the subscription price of each Telecom Italia Ordinary Share resulting from the exercise of the option was adjusted for each plan, dividing the exercise price of the options already determined by the respective assignment ratio;
- merger of TIM S.p.A. into Telecom Italia S.p.A.: starting from the date the merger came into effect (June 30, 2005), the holders of the options of the merged company preserved the corresponding subscription rights. However, the number of shares that could originally be subscribed under the TIM S.p.A. plans (one share for each option) was changed on the basis of the exchange ratio established for the shareholders of TIM S.p.A.. Therefore, each option of the pre-merger TIM S.p.A. stock option plans allows the subscription of 1.73 post-merger Telecom Italia S.p.A. Ordinary Shares. Accordingly, the subscription price of each Telecom Italia Ordinary Share resulting from the exercise of the options was adjusted for each plan, dividing the exercise price of the options already determined by the exchange ratio.

With respect to the stock option plans, for the purpose of rendering the representation of the options homogeneous with that of the underlying subscribable shares to which they correspond, and to facilitate their measurement on the basis of the relative subscription prices, the Group has used the concept of equivalent options . Equivalent options mean a quantity of options equal to those that would be necessary for the subscription of post-merger Telecom Italia Ordinary Shares to the extent of one share for each option exercised, or, more simply, a quantity of options equal to the number of Telecom Italia Ordinary Shares subscribable post-merger.

In this manner, the weighted average prices and the exercise prices indicated below, since they refer, depending on the cases, to the list prices of the assignable shares (eventually adjusted following the above mergers) or equivalent options, are consistent and directly comparable among each other.

The Telecom Italia stock option plans for the period from December 31, 2005 to December 31, 2006 are presented below.

- In the meeting held on September 11, 2000, the Telecom Italia S.p.A. Board of Directors approved the introduction of the Stock Option Plan 2000 , with 51,430,000 options granted at an exercise price of 13.815 per option. Such options, following the merger of Telecom Italia S.p.A. into Olivetti S.p.A., correspond to 169,763,796 equivalent options, at an exercise price of 4.185259 per equivalent option.

The options were divided into three lots of 15,460,000 options each (51,031,466 equivalent options), vesting, respectively, in July 2001, 2002 and 2003 and an extraordinary fourth lot of 5,050,000 options

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(16,669,399 equivalent options) vesting in July 2003. The Stock Option Plan 2000 provides for different expiration dates depending on the date the options vest: the first lot expired in July 2006, the second expires in June 2007, the third lot and the extraordinary lot in June 2008. For each of the first three lots, the options vested on condition that a performance parameter was met which was linked to the ratio of the arithmetic mean of the official market prices of Telecom Italia Ordinary Shares (considered over a specific period of time) to the arithmetic mean of the corresponding values of the Dow Jones Eurostoxx for the Telecommunications sector. The first and second lots met the performance criteria and, consequently, the options vested. The third lot and the extraordinary lot did not meet the performance criteria and, therefore, such options did not vest and were forfeited in 2003.

At December 31, 2005, 10,699,996 options of the Stock Option Plan 2000 were outstanding and corresponded to 35,319,216 equivalent options. In July 2006, the deadline for exercising the first lot expired and the rights relating to 5,349,998 options were forfeited.

At December 31, 2006, 5,349,998 options of the Stock Option Plan 2000 are outstanding and correspond to 17,659,608 equivalent options, at an exercise price equal to 4.185259 per equivalent option.

At the end of 2006 and 2005, the market price of Telecom Italia Ordinary Shares was lower than the exercise price per equivalent option.

- In the meeting held on July 27, 2001, the Telecom Italia S.p.A. Board of Directors approved the introduction of the Stock Option Plan 2001, with 67,025,000 options granted to managers and middle management of the Group at an exercise price of 10.488 per option. Such options, following the merger of Telecom Italia S.p.A. into Olivetti S.p.A., correspond to 221,240,879 equivalent options, at an exercise price of 3.177343 per equivalent option.

The options were divided into two lots of 33,512,500 options each, vesting, respectively, in April 2002 and 2003, expiring, respectively, in April 2007 and 2008. For each of the two lots, the options vested on condition that a performance parameter was met which was linked to the ratio of the arithmetic mean of the official market prices of Telecom Italia Ordinary Shares (considered over a specific period of time) to the arithmetic mean of the corresponding values of the Dow Jones Eurostoxx for the Telecommunications sector. The first lot met the performance criteria and, consequently, the options vested. The second lot, instead, did not meet the performance criteria and, therefore, such options did not vest and were forfeited in 2003.

At December 31, 2005, 31,862,500 options, of the Stock Option Plan 2001 were outstanding and corresponded to 105,173,383 equivalent options. During 2006, the rights to 15,000 options lapsed due to the termination of employment.

At December 31, 2006, 31,847,500 options are outstanding and correspond to 105,123,871 equivalent options, at an exercise price equal to 3.177343 per equivalent option.

At the end of 2006 and 2005, the market value of Telecom Italia Ordinary Shares was lower than the exercise price per equivalent option.

- In the meeting held on February 13, 2002, the Telecom Italia S.p.A. Board of Directors approved the introduction of the Stock Option Plan 2002 Top , with 11,800,000 options granted to sixteen top managers of the Group at an exercise price of 9.203 per option. Such options, following the merger of Telecom Italia S.p.A., into Olivetti S.p.A. correspond to 38,950,278 equivalent options, at an exercise price of 2.788052 per equivalent option.

The options of the Stock Option Plan 2002 Top were not subject to reaching performance parameters and vested by February 2005 and expire in February 2010.

At December 31, 2005 and December 31, 2006, 9,480,001.33 options of Stock Option Plan 2002 Top were outstanding and corresponded to 31,292,243 equivalent options, at an exercise price equal to 2.788052 per equivalent option.

At the end of 2006 and 2005, the market value of Telecom Italia Ordinary Shares was lower than the exercise price per equivalent option.

In the meeting held on March 26, 2002, the Telecom Italia S.p.A. Board of Directors considered the objective ineffectiveness of the Stock Option Plan 2000 Top as an incentive and as a means of retaining

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management loyalty, in relation to the exercise price of the options compared to the general market trend of the stock market. As a result, the Board approved the introduction of the Stock Option Plan 2002, set aside for management of the Group who were already grantees of the Stock Option Plan 2000 and other managers hired after July 27, 2001 (starting date of the Stock Option Plan 2001). The grantees of the original Stock Option Plan 2000, on condition of voluntarily relinquishing the relative options, could take part in the new plan. The options of the Stock Option Plan 2002 were not subject to reaching performance parameters and vested by March 2005 and expire in March 2010.

The options were granted as follows:

1. in March 2002, 29,958,000 options were granted at an exercise price of 9.665 per option. Such options, following the merger of Telecom Italia S.p.A. into Olivetti S.p.A., correspond to 98,887,493 equivalent options, at an exercise price of 2.928015 for each equivalent option.

At December 31, 2005, 19,905,053.50 options granted in March 2002 were outstanding and corresponded to 65,703,601 equivalent options. During 2006, 4,104,000 options lapsed due to the termination of employment.

At December 31, 2006, 15,801,053.50 options are outstanding and correspond to 52,156,879 equivalent options, at an exercise price equal to 2.928015 per equivalent option.

At the end of 2006 and 2005, the market value of Telecom Italia Ordinary Shares was lower than the exercise price per equivalent option;

2. in August 2002, 840,000 options were granted at an exercise price of 7.952 per option. Such options, following the merger of Telecom Italia S.p.A. into Olivetti S.p.A., correspond to 2,772,723 equivalent options, at an exercise price equal to 2.409061 per equivalent option.

At December 31, 2005, 719,000.43 options granted in August 2002 were outstanding and corresponded to 2,373,319 equivalent options, at an exercise price equal to 2.409061 per equivalent option. During 2006, 49,000 options lapsed due to the termination of service.

At December 31, 2006, 670,000.43 options are outstanding and correspond to 2,211,577 equivalent options, at an exercise price equal to 2.409061 per equivalent option.

At the end of 2006, the market value of Telecom Italia Ordinary Shares was lower than the exercise price per equivalent option whereas at the end of 2005 it was higher.



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The stock option plans awarded at the time by TIM (pre-merger into Telecom Italia S.p.A.) for the period from December 31, 2005 to December 31, 2006 are described below.

- In the meeting held on December 22, 1999, the TIM S.p.A. Board of Directors approved the introduction of the Stock Option Plans 2000-2002 , with 21,210,000 options granted at an exercise price of 6.42 per option. Such options, following the merger of TIM S.p.A. into Telecom Italia S.p.A., correspond to 36,693,300 equivalent options, at an exercise price of 3.710983 per equivalent option.

The options can be exercised subject to reaching an objective minimum parameter to be measured with reference to the results achieved by the company in terms of E.V.A. (Economic Value Added), net of financial investments, compared to the minimum measurement indicated in the annual budget, respectively, in the years 1999, 2000 and 2001. The parameter was reached and, consequently, the options vested by the end of 2002 and expire in December 2008.

At December 31, 2005, 11,735,653 options of the Stock Option Plans 2000-2002 were outstanding and corresponded to 20,302,679 equivalent options. During 2006, the rights to 1,939,997 lapsed due to the termination of employment.

At December 31, 2006, 9,795,656 options are outstanding and correspond to 16,946,391 equivalent options, at an exercise price equal to 3.710983 per equivalent option.

At the end of 2006 and 2005, the market value of Telecom Italia Ordinary Shares was lower than the exercise price per equivalent option.

- In the meeting held on February 12, 2002, the TIM S.p.A. board of directors approved the introduction of the Stock Option Plans 2002-2003 , with 25,510,000 options granted to managers and employees at

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an exercise price of 5.67 per option. Such options, following the merger of TIM S.p.A. into Telecom Italia S.p.A., corresponded to 44,132,300 equivalent options, at an exercise price of 3.277457 per equivalent option.

The options of the Stock Option Plans 2002-2003 were not subject to reaching performance parameters, vested by the end of December 2003 and expire in December 2008.

At December 31, 2005, 22,025,000 options of the Stock Option Plans 2002-2003 were outstanding and corresponded to 38,103,250 equivalent options. During 2006, the rights to 4,630,000 options lapsed due to the termination of employment.

At December 31, 2006, 17,395,000 options are outstanding and correspond to 30,093,350 equivalent options, at an exercise price equal to 3.277457 per equivalent option.

At the end of 2006 and 2005, the market value of Telecom Italia Ordinary Shares was lower than the exercise price per equivalent option.

- In the meeting held on May 6, 2002, the TIM S.p.A. Board of Directors approved the introduction of the Stock Option Plans 2003-2005 set aside for management of the Group who already held options in the Stock Option Plans 2001-2003 and the Supplementary Plans 2001-2003 and new grantees. The grantees who already held options in the previous plans could take advantage of the new plans, on condition of voluntarily relinquishing the relative options beforehand. The Stock Option Plans 2003-2005 provided for 50,057,000 options to be granted at an exercise price equal to 5.07 per option. Such options, following the merger of TIM S.p.A. into Telecom Italia S.p.A., correspond to 86,598,610 equivalent options, at an exercise price of 2.930636 per equivalent option. Of the total options, 48,142,000 were granted to grantees of the previous plans and 1,915,000 were granted to new grantees.

The options of the Stock Option Plans 2003-2005 were not subject to reaching performance parameters, vested by December 2004 and expire in December 2010.

At December 31, 2005, 1,915,900 options of the Stock Option Plans 2003-2005 were outstanding and corresponded to 3,314,507 equivalent options. During 2006, the rights to 230,000 options lapsed due to the termination of employment.

At December 31, 2006, 1,685,900 options are outstanding and correspond to 2,916,605 equivalent options, at an exercise price equal to 2.930636 per equivalent option.

At the end of 2006 and 2005, the market value of Telecom Italia Ordinary Shares was lower than the exercise price per equivalent option.

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Movements in TIM stock option plans for the period from December 31, 2004 to June 30, 2005, effective date of the merger of TIM into Telecom Italia are presented in the following table.

|   | Number of<br>options | Weighted<br>Average<br>price per<br>option<br><br>(Euro) |
|---|----------------------|--|
| <b>Options outstanding at December 31, 2004</b>           | <b>45,132,319</b>    | <b>5.87</b>  |
| Exercised   | (5,945,100)          | 5.07   |
| Lapsed(1)   | (1,136,666)          | 5.90   |
| <b>Options outstanding at June 30, 2005</b>               | <b>38,050,553</b>    | <b>5.99</b>  |
| <b>Equivalent options outstanding at June 30, 2005(2)</b> | <b>65,827,457</b>    | <b>3.46</b>  |

(1) These options lapsed since they could no longer be exercised as a result of the termination of employment and/or other reasons (e.g. relinquished by the interested party).

(2) Equivalent number of options and relative weighted average price deriving from the application of the TIM Telecom Italia conversion ratio equal to 1.73.

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Movements in all Telecom Italia stock option plans for the period from December 31, 2004 to December 31, 2006 (including plans granted by Tim S.p.A.) are presented in the following table:

|   | Number of<br>equivalent<br>options | Weighted<br>Average<br>price per<br>equivalent<br>option<br><br>(Euro) |
|---|------------------------------------|--|
| <b>Options outstanding at December 31, 2004</b>                 | <b>253,230,091</b>                 | <b>3.18</b>  |
| Lapsed at January 1, 2005                                       | (755,890)                          | 3.02   |
| Exercised   | (9,174,215)                        | 2.83   |
| Lapsed(1)   | (4,623,274)                        | 3.04   |
| Expired and Forfeited(2)  | (2,921,970)                        | 4.82   |
| Equivalent options coming from the merged company TIM S.p.A.(3) | 65,827,456                         | 3.46   |
| <b>Options outstanding at December 31, 2005</b>                 | <b>301,582,198</b>                 | <b>3.24</b>  |
| Lapsed(1)   | (25,522,066)                       | 3.14   |
| Expired and Forfeited(2)  | (17,659,608)                       | 4.19   |
| <b>Options outstanding at December 31, 2006</b>                 | <b>258,400,524</b>                 | <b>3.19</b>  |

(1) These equivalent options lapsed since they could no longer be exercised as a result of the termination of employment and/or other reasons (e.g. relinquished by the interested party).

(2) These equivalent options expired since they were not exercised during the stated period or forfeited since they did not become vested due to failure to reach the performance parameters.

(3) Equivalent number of options coming from the merged company TIM S.p.A. outstanding at June 30, 2005 (effective date of the merger into Telecom Italia S.p.A.).

The following tables present, with reference to the Telecom Italia stock option plans outstanding at December 31, 2006 and 2005, grouped by the range of exercise price, the residual weighted average life and the weighted average grant price of the equivalent options:

| Range of Prices | Equivalent Options Outstanding at<br>December 31, 2006 |   |                                       | Equivalent Options<br>Exercisable at<br>December 31, 2006 |                                       |
|-----------------|--|---|---------------------------------------|---|---------------------------------------|
|                 | Equivalent<br>Options                                  | Residual<br>Weighted<br>Average<br>Life | Weighted<br>Average<br>Grant<br>Price | Equivalent<br>Options                                     | Weighted<br>Average<br>Grant<br>Price |

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|           | (Euro)             | (years) | (Euro) | (Euro)             | (Euro) |
|-----------|--------------------|---------|--------|--------------------|--------|
| 2.41      | 2,211,577          | 2.27    | 2.41   | 2,211,577          | 2.41   |
| 2.78-2.94 | 86,365,727         | 2.34    | 2.88   | 86,365,727         | 2.88   |
| 3.17-3.72 | 152,163,612        | 0.82    | 3.26   | 152,163,612        | 3.26   |
| 4.19      | 17,659,608         | 0.50    | 4.19   | 17,659,608         | 4.19   |
|           | <b>258,400,524</b> |         |        | <b>258,400,524</b> |        |

| Range of Prices | Equivalent Options Outstanding at<br>December 31, 2005 |   |                                       | Equivalent Options<br>Exercisable at<br>December 31, 2005 |                                       |
|-----------------|--|---|---------------------------------------|---|---------------------------------------|
|                 | Equivalent<br>Options                                  | Residual<br>Weighted<br>Average<br>Life | Weighted<br>Average<br>Grant<br>Price | Equivalent<br>Options                                     | Weighted<br>Average<br>Grant<br>Price |
| (Euro)          | (Euro)   | (years)                                 | (Euro)                                | (Euro)  | (Euro)                                |
| 2.41            | 2,373,319  | 3.30                                    | 2.41                                  | 2,373,319   | 2.41                                  |
| 2.78-2.94       | 100,310,351  | 3.34                                    | 2.88                                  | 100,310,351   | 2.88                                  |
| 3.17-3.72       | 163,579,312  | 1.90                                    | 3.27                                  | 163,579,312   | 3.27                                  |
| 4.19            | 35,319,216   | 1.00                                    | 4.19                                  | 35,319,216  | 4.19                                  |
|                 | <b>301,582,198</b>                                     |   |                                       | <b>301,582,198</b>  |                                       |

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***Telecom Italia Media S.p.A. Stock Option Plans***

All the options in the stock option plans of Telecom Italia Media give the right to subscribe to a quantity of Telecom Italia Media Ordinary Shares equal to the number of options exercised, at a specific exercise price.

The Telecom Italia Media stock option plans for the period from December 31, 2005 to December 31, 2006 are presented below.

- In the meeting held on May 17, 2002, the Telecom Italia Media S.p.A. (formerly Seat S.p.A.) Board of Directors approved the introduction of the Key People Plan , with 46,400,000 options granted at an exercise price of 0.8532.

The rights of the Key People Plan vested by May 2005 and expire in May 2008.

At December 31, 2005 and December 31, 2006, 2,250,000 options were outstanding.

At the end of 2006 and 2005, the market price of Telecom Italia Media Ordinary Shares was lower than the exercise price.

- In the meeting held on February 23, 2005, the Telecom Italia Media S.p.A. Board of Directors approved the introduction of the Plan 2005 , set aside for employees in service at Telecom Italia Media and its subsidiaries, identified on the basis of their specific responsibilities and/or expertise who were already grantees of the Stock Option Plan 2000-2002 and the Key People Plan. The grantees of the previous plans, on condition of voluntarily relinquishing the relative options beforehand, could take part in the new plan. The previous plans, however, remain in place at the same conditions, procedures and regulations for the employee grantees of the other Companies of the Telecom Italia Group, for retired employees and for employees of the Media Business Unit who did not relinquish the options.

Under the Plan 2005, 39,725,000 options were granted at an exercise price of 0.3826.

The options are divided into three lots, respectively of 15,890,000, 11,917,500 and 11,917,500 options, vesting, respectively, in July 2005, January 2006 and January 2007 and all expiring in December 2008.

At December 31, 2005, 25,254,830 options were outstanding. During the first half of 2006, 6,100,000 options were exercised and 1,872,500 options lapsed as a result of the termination of service.

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At December 31, 2006, 17,282,330 options were outstanding.

At December 31, 2005, the market price of Telecom Italia Media Ordinary Shares was higher than the exercise price, while at December 31, 2006, the market price was lower.

On February 23, 2005, at the same time the options relating to the Plan 2005 were granted, the fair value of these options was determined, using the binomial CRR model on the basis of the following variables:

- price of the share resulting from the exercise of the options: 0.3826 (average of the official market prices of Telecom Italia Media Ordinary Shares from January 23, 2005 to February 23, 2005 - opening and closing dates included);
- exercise price: equal to the price of the share resulting from the exercise of the options ( 0.3826);
- volatility: at the date of valuation, the historical volatility of the stock of 37.30% was used;
- option period: 3.85 years (from February 23, 2005 to December 31, 2008, corresponding to the end of the life of the option);
- expected dividends: zero, on the basis of the consideration that Telecom Italia Media up to February 23, 2005 has never paid out dividends;
- risk-free interest rate: the rate on Italian Government securities (BTP) was considered, interpolated at the expiration date of the option: December 31, 2008. Therefore, a rate of 2.82% was applied.

The fair value was determined as 0.1246 per option.

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Movements in all Telecom Italia Media stock option plans from December 31, 2004 to December 31, 2006 are presented in the following table.

|   | <b>Number of<br/>options</b> | <b>Weighted<br/>Average price<br/>per option</b> |
|---|------------------------------|--|
|   |                              | (Euro)   |
| <b>Options outstanding at December 31, 2004</b> | <b>15,840,313</b>            | <b>0.87</b>                                      |
| Granted   | 39,725,000                   | 0.38   |
| Exercised                                       | (11,005,170)                 | 0.38   |
| Expired and Forfeited(1)                        | (234,073)                    | 1.22   |
| Lapsed(2)                                       | (16,821,240)                 | 0.77   |
| <b>Options outstanding at December 31, 2005</b> | <b>27,504,830</b>            | <b>0.42</b>                                      |
| Exercised                                       | (6,100,000)                  | 0.38   |
| Lapsed(2)                                       | (1,872,500)                  | 0.38   |
| <b>Options outstanding at December 31, 2006</b> | <b>19,532,330</b>            | <b>0.44</b>                                      |

(1) These equivalent options expired since they were not exercised during the stated period or were forfeited since they did not become vested because of failure to reach the performance parameters.

(2) These options lapsed since they could no longer be exercised as a result of the termination of employment and/or for other reasons (e.g. relinquished by the interested party).

The following tables present, with reference to the stock option plans outstanding at December 31, 2006 and 2005, grouped by the range of exercise price, the residual weighted average life and the weighted average price of the option grants:

| Range of Prices | Options Outstanding at |   |                                       | Options Exercisable at |                                       |
|-----------------|------------------------|---|---------------------------------------|------------------------|---------------------------------------|
|                 | December 31, 2006      |   |                                       | December 31, 2006      |                                       |
|                 | Options                | Residual<br>Weighted<br>Average<br>Life | Weighted<br>Average<br>Grant<br>Price | Options                | Weighted<br>Average<br>Grant<br>Price |
| (Euro)          | (years)                | (Euro)                                  |                                       | (Euro)                 |                                       |
| 0.38            | 17,282,330             | 2.00                                    | 0.38                                  | 7,569,830              | 0.38                                  |
| 0.85            | 2,250,000              | 1.42                                    | 0.85                                  | 2,250,000              | 0.85                                  |
|                 | <b>19,532,330</b>      |   |                                       | <b>9,819,830</b>       |                                       |



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At December 31, 2006, 19,532,330 options were outstanding, of which 9,819,830 were exercisable at that date. The remaining 9,712,500 will become exercisable starting from January 2007.

| Range of Prices<br><br>(Euro) | Options Outstanding at<br>December 31, 2005 |   |                                       | Options Exercisable at<br>December 31, 2005 |                                       |
|-------------------------------|---|---|---------------------------------------|---|---------------------------------------|
|                               | Options                                     | Residual<br>Weighted<br>Average<br>Life | Weighted<br>Average<br>Grant<br>Price | Options                                     | Weighted<br>Average<br>Grant<br>Price |
|                               |   | (years)                                 | (Euro)                                |   | (Euro)                                |
| 0.38                          | 25,254,830                                  | 3.00                                    | 0.38                                  | 4,044,830                                   | 0.38                                  |
| 0.85                          | 2,250,000                                   | 2.42                                    | 0.85                                  | 2,250,000                                   | 0.85                                  |
|                               | <b>27,504,830</b>                           |   |                                       | <b>6,294,830</b>                            |                                       |

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**Table of Contents****Financial Statements****Notes To Consolidated Financial Statements****NOTE 43 OTHER INFORMATION****a) Exchange rate used to translate foreign currency financial statements(1)**

| (Local Currency units for 1 Euro) | Balance sheet items     |             |             | Statement of income items   |             |             |
|-----------------------------------|-------------------------|-------------|-------------|-----------------------------|-------------|-------------|
|                                   | Year-end exchange rates |             |             | Average exchange rates for  |             |             |
|                                   | as of December 31,      |             |             | the year ended December 31, |             |             |
|                                   | 2006                    | 2005        | 2004        | 2006                        | 2005        | 2004        |
|                                   | (currency/Euro)         |             |             |                             |             |             |
| <b>Europe</b>                     |                         |             |             |                             |             |             |
| CHF Swiss Franc                   | 1.60690                 | 1.55510     | 1.54290     | 1.57294                     | 1.54822     | 1.54382     |
| GBP Pound Sterling                | 0.67150                 | 0.68530     | 0.70505     | 0.68178                     | 0.68379     | 0.67867     |
| TRY Turkish Lira (*)              | 1.85150                 | 1.58750     | 1.82680     | 1.79800                     | 1.67000     | 1.76698     |
| <b>North America</b>              |                         |             |             |                             |             |             |
| CAD Canadian Dollar               | 1.52810                 | 1.37250     | 1.64160     | 1.42361                     | 1.50924     | 1.61675     |
| U.S. Dollar                       | 1.31700                 | 1.17970     | 1.36210     | 1.25552                     | 1.24436     | 1.24390     |
| <b>Central and South America</b>  |                         |             |             |                             |             |             |
| VEB Venezuelan Bolivar (*)        | 2,831.55000             | 2,536.35500 | 2,615.23200 | 2,699.36800                 | 2,628.83494 | 2,321.68959 |
| BOB Bolivian                      | 10.45698                | 9.37862     | 10.92677    | 9.97464                     | 9.99316     | 9.85905     |
| PEN Peruvian Nuevo Sol            | 4.20782                 | 4.05522     | 4.47041     | 4.10882                     | 4.09907     | 4.24376     |
| ARS Argentine Peso                | 4.03265                 | 3.57685     | 4.05770     | 3.86013                     | 3.63771     | 3.65974     |
| CLP Chilean Peso                  | 701.30250               | 604.59625   | 759.37075   | 666.01290                   | 695.98714   | 757.93009   |
| COP Colombian Peso                | 2,948.10450             | 2,695.67349 | 3,200.93500 | 2,963.62507                 | 2,886.68182 | 3,264.30912 |
| MXN Mexican Peso                  | 14.26970                | 12.58303    | 15.17924    | 13.68708                    | 13.54809    | 14.03686    |
| BRL Brazilian Real                | 2.81575                 | 2.76132     | 3.61556     | 2.73341                     | 3.02888     | 3.63932     |
| <b>Other countries</b>            |                         |             |             |                             |             |             |
| HKD Hong Kong Dollar              | 10.24090                | 9.14740     | 10.58810    | 9.75391                     | 9.67904     | 9.68811     |
| SGD Singapore Dollar              | 2.02020                 | 1.96280     | 2.22620     | 1.99387                     | 2.07066     | 2.10156     |
| ILS Israeli Shekel                | 5.54786                 | 5.42426     | 5.87746     | 5.59097                     | 5.57951     | 5.56505     |
| JPY Japanese Yen                  | 156.93000               | 138.90000   | 139.65000   | 146.02074                   | 136.84625   | 134.44459   |

1) Source: Data processed by Central European Bank, Reuters and major Central Banks.

(\*) Turkey and Venezuela have been considered high-inflation countries until December 31, 2005 and for them, the year-end exchange rates have been used to translate the statements of income items.

**b) Research and development**

During the year 2006, research and development activities by the Telecom Italia Group were mainly carried out by the Innovation & Engineering Services function (ex-Telecom Italia Lab) under Operations, also in collaboration with Pirelli Labs, and by Olivetti S.p.A.

The total costs incurred in 2006 amount to approximately 133 million ( 180 million in 2005 and 181 million in 2004) and are represented by external costs, labor costs of dedicated staff and depreciation and amortization.

Such costs were mainly incurred by the Wireline and Domestic Mobile Business Units.

The research activities expensed during the year amount to 76 million ( 128 million in 2005 and 144 million in 2004). The activities relating to development, which became available for use during the year, were capitalized to the network or to software costs for an amount equal to 57 million ( 52 million in 2005 and 37 million in 2004).

Research and development activities conducted by the Telecom Italia Group are detailed in the Report on Operations in the Item 5. Operating and Financial Review and Prospects 5.7 Research, Development and Innovation .

#### **c) Operating leases**

##### **Revenue-related**

The Group has signed lease contracts for direct connections, in particular numeric and analog lines, offered under wholesale plans to interconnecting operators.

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At December 31, 2006 and 2005, the amounts of lease installments receivable on non-cancelable lease contracts, which decreased from last year due to reduction of one year of the relevant expiration dates, are the following:

|                   | <u>At December 31,</u> |             |
|-------------------|------------------------|-------------|
|                   | <u>2006</u>            | <u>2005</u> |
|                   | (millions of Euro)     |             |
| Within 1 year     | 10                     | 152         |
| From 2 to 5 years |                        | 88          |
| <b>Total</b>      | <b>10</b>              | <b>240</b>  |

**Expense-related**

The Group has signed lease contracts for buildings (for periods from 6 to 9 years) and lines. At December 31, 2006 and 2005, the amounts of lease installments payable on non-cancelable lease contracts are the following:

|                   | <u>At December 31,</u> |              |
|-------------------|------------------------|--------------|
|                   | <u>2006</u>            | <u>2005</u>  |
|                   | (millions of Euro)     |              |
| Within 1 year     | 355                    | 233          |
| From 2 to 5 years | 788                    | 716          |
| Beyond 5 years    | 323                    | 311          |
| <b>Total</b>      | <b>1,466</b>           | <b>1,260</b> |

**NOTE 44 EVENTS SUBSEQUENT TO DECEMBER 31, 2006**

- **Revolving Credit Facility expiring 2012**

On January 15, 2007, 2 billion of the remaining available syndicated credit line expiring in March 2007 was cancelled and at the same time the revolving credit facility of 6 billion expiring in 2012 was increased by the same amount. The new amount of the revolving credit facility is therefore equal to 8 billion.

As a result of the above, Telecom Italia S.p.A. has kept its unused committed credit lines at 6.6 billion and extended the average term of the facility.

- **Bersani Decree (Decree Law 7, dated January 31, 2007)**

In January 2007, the Italian Government enacted the Bersani Decree (Decree Law 7, dated January 31, 2007) which establishes the elimination of the fixed top-up cost for recharging prepaid phone cards. It also prohibits fixing a date for the expiration of the remaining prepaid credit on the card and eliminates certain penalties for rescinding from the subscription contract with mobile operators before expiration. Telecom Italia has estimated the potential negative impact of the Bersani Decree on revenues for 2007 in the range of 350-400 million. This takes into account the effect of the potential changes in market share (as a result of pricing policies), the flexibility with respect to traffic volumes, the possible re-balancing of retail rates and the efficiencies attainable on recharging costs.

- **Repayment of Telecom Italia S.p.A. 5.625% bonds due 2007**

On February 1, 2007, at maturity, Telecom Italia repaid the 5.625% bonds in the principal amount of 1,250 million.

- **Finalization of the acquisition of the AOL Internet activities in Germany from Time Warner**

On February 28, 2007, the transaction was finalized for the purchase by the Telecom Italia Group of the assets relating to the Internet access business in Germany (broadband and narrowband) from the Time Warner/AOL Group. The total internet access portfolio has approximately 2.1 million customers. The consideration paid was 665 million.

The transaction, which was approved in November 2006 by the European antitrust authority, was concluded after the seller provided proof of the definitive completion of the process to simplify the corporate chain which constituted the last condition to finalizing the transaction.

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At the same time the internet access business was purchased, a 5-year commercial partnership was also agreed with the Time Warner/AOL group which will involve the creation of a dedicated portal under a joint brand, managed by AOL, which will represent the home page for Telecom Italia's entire customer base in Germany. A revenue-sharing agreement is also envisaged which will be based on the number of visits to that portal and the use of the services offered with proceeds estimated at approximately 20 million for the Telecom Italia Group.

The valuations necessary for purposes of that allocation, at February 28, 2007, of the cost of the business combination to the acquired assets and liabilities is currently in progress.

**NOTE 45 LIST OF COMPANIES OF THE TELECOM ITALIA GROUP**

In accordance with Consob resolution No. 11971 dated May 14, 1999, as amended and Consob Communication DEM/6064293 dated July 28, 2006, the list of significant companies and investments held by the Group is provided herein.

The list is divided by type of investment, consolidation method and business segment.

The following is indicated for each company: name, head office, country, the share capital in the original currency, in addition to the percentage holding of share capital, the percentage of voting rights in the ordinary shareholders' meeting if different than the percentage holding of share capital, and which companies hold the investment.

**List of companies consolidated on a line-by-line basis**

| <b>Name</b>                                   | <b>Head Office</b>     | <b>Currency</b> | <b>Share Capital</b> | <b>% ownership</b> | <b>% of voting rights</b> | <b>Held by</b>                                  |
|---|------------------------|-----------------|----------------------|--------------------|---------------------------|---|
| <b>WIRELINE</b>                               |                        |                 |                      |                    |                           |   |
| TELECOM ITALIA S.P.A. (WIRELINE BUSINESS)     |                        |                 |                      |                    |                           |   |
| BBEYOND B.V.<br>(telecommunications services) | AMSTERDAM<br>(HOLLAND) | EUR             | 18,000               | 100.0000           |                           | BBNED N.V.                                      |
| BBNED N.V.<br>(telecommunications services)   | AMSTERDAM<br>(HOLLAND) | EUR             | 82,430,000           | 99.9939<br>0.0061  |                           | TELECOM ITALIA INTERNATIONAL N.V.<br>BBNED N.V. |

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|   |                             |     |            |                   |   |
|---|-----------------------------|-----|------------|-------------------|---|
| ELETTRA TLC S.p.A.<br>(services rendered in connection with submarine cable systems for telecommunications) | ROME<br>(ITALY)             | EUR | 10,329,200 | 70.0000           | MEDITERRANEAN NAUTILUS S.A.   |
| HANSENET TELEKOMMUNIKATION GmbH<br>(telecommunications services)  | HAMBURG<br>(GERMANY)        | EUR | 91,521,500 | 100.0000          | TELECOM ITALIA DEUTSCHLAND HOLDING GmbH   |
| I.T. TELECOM S.r.l.<br>(other software development and software consulting)                                 | POMEZIA<br>(ROME<br>-ITALY) | EUR | 7,000,000  | 100.0000          | TELECOM ITALIA S.p.A.   |
| INTERCALL S.A.<br>(audiotex services and sale of prepaid phone cards)                                       | PARIS<br>(FRANCE)           | EUR | 807,060    | 88.6342           | LIBERTY SURF GROUP S.A.S  |
| LATIN AMERICAN NAUTILUS ARGENTINA S.A.<br>(installation and maintenance of submarine cable systems)         | BUENOS AIRES<br>(ARGENTINA) | ARS | 9,998,000  | 95.0000<br>5.0000 | LATIN AMERICAN NAUTILUS LTD<br>LATIN AMERICAN NAUTILUS S.A.                           |
| LATIN AMERICAN NAUTILUS BOLIVIA SRL<br>(installation and maintenance of submarine cable systems)            | LA PAZ<br>(BOLIVIA)         | BOB | 6,730,600  | 99.9985<br>0.0015 | LATIN AMERICAN NAUTILUS S.A.<br>LATIN AMERICAN NAUTILUS USA Inc.                      |
| LATIN AMERICAN NAUTILUS BRASIL Ltda<br>(installation and maintenance of submarine cable systems)            | RIO DE JANEIRO<br>(BRAZIL)  | BRL | 63,900     | 99.9999<br>0.0001 | LATIN AMERICAN NAUTILUS BRASIL PARTICIPACOES LTDA<br>LATIN AMERICAN NAUTILUS USA Inc. |

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|--|-----------------------------|----------|---------------|--|--------------------|---|
| Name   | Head Office                 | Currency | Share Capital | % ownership                                | % of voting rights | Held by   |
| LATIN AMERICAN NAUTILUS BRASIL PARTICIPACOES Ltda<br>(holding company)                                 | RIO DE JANEIRO<br>(BRAZIL)  | BRL      | 2,058,168     | 100.0000                                   |                    | LATIN AMERICAN NAUTILUS LTD   |
| LATIN AMERICAN NAUTILUS CHILE S.A.<br><br>(installation and maintenance of submarine cable systems)    | SANTIAGO<br><br>(CHILE)     | CLP      | 9,265,000,000 | 100.0000                                   |                    | LATIN AMERICAN NAUTILUS LTD   |
| LATIN AMERICAN NAUTILUS COLOMBIA Ltda<br><br>(installation and maintenance of submarine cable systems) | BOGOTA<br><br>(COLOMBIA)    | COP      | 240,225,000   | 100.0000                                   |                    | LATIN AMERICAN NAUTILUS LTD   |
| LATIN AMERICAN NAUTILUS Ltd<br>(installation and maintenance of submarine cable systems)               | DUBLIN<br>(IRELAND)         | USD      | 1,000,000     | 100.0000                                   |                    | LATIN AMERICAN NAUTILUS S.A.  |
| LATIN AMERICAN NAUTILUS MEXICO S.A.<br><br>(installation and maintenance of submarine cable systems)   | MEXICO D.F.<br><br>(MEXICO) | MXN      | 100,000       | 99.9900                                    | 0.0100             | LATIN AMERICAN NAUTILUS LTD<br><br>LATIN AMERICAN NAUTILUS USA Inc. |
| LATIN AMERICAN NAUTILUS PANAMA S.A.<br>(installation and maintenance of submarine cable systems)       | PANAMA                      | USD      | 10,000        | 100.0000                                   |                    | LATIN AMERICAN NAUTILUS LTD   |
| LATIN AMERICAN NAUTILUS PERU S.A.<br><br>(installation and maintenance of submarine cable systems)     | LIMA<br><br>(PERU)          | PEN      | 56,704,995    | 100.0000                                   |                    | LATIN AMERICAN NAUTILUS LTD   |
| LATIN AMERICAN NAUTILUS S.A.<br>(holding company)  | LUXEMBOURG<br>(LUXEMBOURG)  | USD      | 55,500,000    | 99.9999                                    | 0.0001             | TELECOM ITALIA SPARKLE S.p.A.<br>TELECOM ITALIA FINANCE S.A.        |
| LATIN AMERICAN NAUTILUS SERVICE Inc.<br><br>(installation and maintenance of submarine cable systems)  | FLORIDA<br><br>(USA)        | USD      | 10,000        | 100.0000                                   |                    | LATIN AMERICAN NAUTILUS USA Inc.                                    |
| LATIN AMERICAN NAUTILUS St. Croix LLC<br>(installation and maintenance of submarine cable systems)     | VIRGIN ISLANDS<br>(USA)     | USD      | 10,000        | 100.0000                                   |                    | LATIN AMERICAN NAUTILUS LTD.  |



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|  |                            |     |             |          |   |
|--|----------------------------|-----|-------------|----------|---|
| LATIN AMERICAN NAUTILUS USA Inc.<br><br>(installation and maintenance of submarine cable systems)  | FLORIDA<br><br>(USA)       | USD | 20,000      | 100.0000 | LATIN AMERICAN NAUTILUS LTD.                |
| LATIN AMERICAN NAUTILUS VENEZUELA C.A.<br><br>(installation and maintenance of submarine cable systems)  | CARACAS<br><br>(VENEZUELA) | VEB | 51,709,000  | 100.0000 | LATIN AMERICAN NAUTILUS LTD.                |
| LIBERTY SURF COMMUNICATIONS LTD (in liquidation)<br><br>(telecommunications services)  | LONDON<br><br>(UK)         | GBP | 1,000       | 100.0000 | LIBERTY SURF NETWORK B.V. (in liquidations) |
| LIBERTY SURF GROUP S.A.S. (holding company)  | PARIS<br>(FRANCE)          | EUR | 282,559,451 | 100.0000 | TELECOM ITALIA S.p.A.                       |
| LIBERTY SURF NETWORK B.V. (in liquidation)<br>(telecommunications services)  | AMSTERDAM<br>(HOLLAND)     | EUR | 20,001      | 100.0000 | LIBERTY SURF GROUP S.A.S.                   |
| LOQUENDO SOCIETA PER AZIONI (research, development and marketing of technologies and equipment regarding voice synthesis recognition and/or interaction) | TURIN<br>(ITALY)           | EUR | 3,573,741   | 99.9846  | TELECOM ITALIA S.p.A.                       |
| MATRIX S.p.A. (internet services)  | MILAN<br>(ITALY)           | EUR | 1,100,000   | 100.0000 | TELECOM ITALIA S.p.A.                       |

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|---|----------------------------|----------|---------------|--|--------------------|--|
| Name  | Head Office                | Currency | Share Capital | % ownership                                | % of voting rights | Held by  |
| MED-1 (NETHERLANDS) B.V.<br>(holding company)   | AMSTERDAM<br>(HOLLAND)     | EUR      | 18,200        | 100.0000                                   |                    | MED-1 SUBMARINE CABLES LTD   |
| MED-1 ITALY S.r.l.<br>(installation and management submarine cable systems in Italian seas)                         | ROME<br>(ITALY)            | EUR      | 548,477       | 100.0000                                   |                    | MED-1 (NETHERLANDS) B.V.   |
| MED-1 SUBMARINE CABLES Ltd<br>(installation and management of cable Lev)  | RAMAT GAN<br>(ISRAEL)      | ILS      | 55,886,866    | 99.9123                                    |                    | TELECOM ITALIA SPARKLE S.p.A.  |
| MEDITERRANEAN NAUTILUS BV<br>(holding company)  | AMSTERDAM<br>(HOLLAND)     | EUR      | 18,003        | 100.0000                                   |                    | MEDITERRANEAN NAUTILUS LTD   |
| MEDITERRANEAN NAUTILUS GREECE S.A.<br><br>(telecommunications services)   | ATHENS<br><br>(GREECE)     | EUR      | 111,600       | 100.0000                                   |                    | MEDITERRANEAN NAUTILUS BV  |
| MEDITERRANEAN NAUTILUS Inc.<br>(telecommunications services)  | DELAWARE<br>(USA)          | USD      | 500           | 100.0000                                   |                    | MEDITERRANEAN NAUTILUS BV  |
| MEDITERRANEAN NAUTILUS ISRAEL Ltd<br><br>(telecommunications services)  | TEL AVIV<br><br>(ISRAEL)   | ILS      | 1,000         | 100.0000                                   |                    | MEDITERRANEAN NAUTILUS BV  |
| MEDITERRANEAN NAUTILUS ITALY S.p.A.<br><br>(installation and management of submarine cable systems)                 | ROME<br><br>(ITALY)        | EUR      | 3,100,000     | 100.0000                                   |                    | MEDITERRANEAN NAUTILUS BV  |
| MEDITERRANEAN NAUTILUS Ltd<br>(telecommunications services, installation and management of submarine cable systems) | DUBLIN<br>(IRELAND)        | USD      | 153,259       | 100.0000                                   |                    | MEDITERRANEAN NAUTILUS S.A.  |
| MEDITERRANEAN NAUTILUS S.A.<br>(holding company)  | LUXEMBOURG<br>(LUXEMBOURG) | EUR      | 100,000,000   | 99.9999<br>0.0001                          |                    | TELECOM ITALIA SPARKLE S.p.A.<br>TELECOM ITALIA FINANCE S.A.   |
| MEDITERRANEAN NAUTILUS TELEKOMÜNİKASYON HİZMETLERİ TİCARET ANONİM ŞİRKETİ<br><br>(telecommunications services)      | ISTANBUL<br><br>(TURKEY)   | TRY      | 350,000       | 99.9988<br>0.0003<br>0.0003                |                    | MEDITERRANEAN NAUTILUS BV<br><br>MEDITERRANEAN NAUTILUS Ltd<br>MEDITERRANEAN NAUTILUS ITALY S.p.A.<br>MEDITERRANEAN NAUTILUS |
|   |                            |          |               | 0.0003<br>0.0003                           |                    | ISRAEL Ltd   |

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|  |                                       |     |            |                       | MEDITERRANEAN NAUTILUS<br>GREECE Ltd                       |
|--|---------------------------------------|-----|------------|-----------------------|--|
| PATH.NET S.p.A.<br>(networking systems and<br>telecommunications)  | ROME<br>(ITALY)                       | EUR | 25,800,000 | 100.0000              | TELECOM ITALIA S.p.A.                                      |
| TELECOM ITALIA DEUTSCHLAND<br>HOLDING GmbH<br><br>(holding company)                                      | HAMBURG<br><br>(GERMANY)              | EUR | 25,000     | 100.0000              | TELECOM ITALIA S.p.A.                                      |
| TELECOM ITALIA NETHERLANDS B.V.<br>(telecommunications services)   | AMSTERDAM<br>(HOLLAND)                | EUR | 18,200     | 100.0000              | TELECOM ITALIA SPARKLE S.p.A.                              |
| TELECOM ITALIA S.A.S.<br>(Internet access provider)  | PARIS<br>(FRANCE)                     | EUR | 3,478,234  | 100.0000              | LIBERTY SURF GROUP S.A.S.                                  |
| TELECOM ITALIA SAN MARINO S.p.A.<br>(telecommunications services in San<br>Marino)                       | FALCIANO<br>REPUBLIC OF<br>SAN MARINO | EUR | 1,808,000  | 99.9999<br><br>0.0001 | TELECOM ITALIA SPARKLE S.p.A.<br><br>TELECOM ITALIA S.p.A. |
| TELECOM ITALIA SPAIN SL<br>UNIPERSONAL<br><br>(telecommunications services)                              | MADRID<br><br>(SPAIN)                 | EUR | 2,003,096  | 100.0000              | TELECOM ITALIA SPARKLE S.p.A.                              |
| TELECOM ITALIA SPARKLE OF<br>NORTH AMERICA. INC.<br><br>(telecommunications and promotional<br>services) | NEW YORK<br><br>(USA)                 | USD | 15,550,000 | 100.0000              | TELECOM ITALIA SPARKLE S.p.A.                              |

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| Name   | Head Office                                    | Currency | Share Capital                              | % ownership       | % of voting rights Held by   |
| TELECOM ITALIA SPARKLE S.p.A.<br>(public and private telecommunication services management)    | ROME<br>(ITALY)                                | EUR      | 200,000,000                                | 100.0000          | TELECOM ITALIA S.p.A.  |
| TELECOM ITALIA SPARKLE SINGAPORE PTE. LTD<br>(telecommunications services)                     | SINGAPORE                                      | USD      | 500,000                                    | 99.9998<br>0.0002 | TELECOM ITALIA SPARKLE S.p.A.<br>TELECOM ITALIA SPARKLE OF NORTH AMERICA. INC. |
| TELECONTACT CENTER S.p.A<br>(telemarketing services)   | NAPLES<br>(ITALY)                              | EUR      | 770,000                                    | 100.0000          | TELECOM ITALIA S.p.A.  |
| TELEFONIA MOBILE SAMMARINESE S.p.A.<br>(mobile telephony services)                             | BORGO<br>MAGGIORE<br>REPUBLIC OF<br>SAN MARINO | EUR      | 78,000                                     | 51.0000           | TELECOM ITALIA SAN MARINO S.p.A.   |
| TELEMEDIA INTERNATIONAL USA Inc.<br><br>(telecommunications services)                          | NEW JERSEY<br><br>(USA)                        | USD      | 154,022,890                                | 100.0000          | TMI TELEMEDIA INTERNATIONAL LTD  |
| THINX-SM TELEHOUSE INTERNET EXCHANGE S.r.l.<br>(housing and hosting)                           | GUALDICCILO<br><br>REPUBLIC OF<br>SAN MARINO   | EUR      | 25,800                                     | 99.0000<br>1.0000 | TELECOM ITALIA SAN MARINO S.p.A.<br>TELECOM ITALIA SPARKLE S.p.A.              |
| TI BELGIUM S.P.R.L. B.V.B.A<br><br>(telecommunications services)                               | BRUSSELS<br><br>(BELGIUM)                      | EUR      | 3,000,000                                  | 99.9967           | TELECOM ITALIA SPARKLE S.p.A.  |
| TI GERMANY GmbH<br><br>(telecommunications services)   | FRANKFURT<br><br>(GERMANY)                     | EUR      | 25,000                                     | 100.0000          | TELECOM ITALIA SPARKLE S.p.A..   |
| TI SWITZERLAND GmbH<br><br>(telecommunications services)                                       | ZURICH<br><br>(SWITZERLAND)                    | CHF      | 2,000,000                                  | 100.0000          | TELECOM ITALIA SPARKLE S.p.A..   |
| TI TELECOM ITALIA (AUSTRIA) TELEKOMMUNICATIONSDIESTE GMBH<br><br>(telecommunications services) | VIENNA<br><br>(AUSTRIA)                        | EUR      | 2,735,000                                  | 100.0000          | TELECOM ITALIA SPARKLE S.p.A.  |
| TI UNITED KINGDOM Ltd<br><br>(telecommunications services)                                     | LONDON<br><br>(UK)                             | GBP      | 4,150,000                                  | 100.0000          | TELECOM ITALIA SPARKLE S.p.A.  |
| TIS FRANCE S.A.S.  | PARIS  | EUR      | 3,295,000                                  | 100.0000          | TELECOM ITALIA SPARKLE S.p.A.  |

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|   |                                  |     |                |          |         |  |
|---|----------------------------------|-----|----------------|----------|---------|--|
| (installation and management of services connected to fixed network and related activities) | (FRANCE)                         |     |                |          |         |  |
| TMI TELEMEDIA INTERNATIONAL Ltd   | LONDON                           | EUR | 3,983,254      | 100.0000 |         | TELECOM ITALIA SPARKLE S.p.A.            |
| (telecommunications services)   | (UK)                             | GBP | 1              |          |         |  |
| TMI TELEMEDIA INTERNATIONAL DO BRASIL LTDA  | SAO PAULO                        | BRL | 2,589,317      | 100.0000 |         | TMI TELEMEDIA INTERNATIONAL LTD          |
| (telecommunications services)   | (BRAZIL)                         |     |                |          |         |  |
| <b>DOMESTIC MOBILE</b>  |                                  |     |                |          |         |  |
| TELECOM ITALIA S.P.A. (MOBILE BUSINESS)   |                                  |     |                |          |         |  |
| <b>BRAZIL MOBILE</b>  |                                  |     |                |          |         |  |
| TIM BRASIL SERVIÇOS E PARTICIPAÇÕES S.A. (holding company)                                  | RIO DE JANEIRO (BRAZIL)          | BRL | 10,948,214,541 | 100.0000 |         | TIM INTERNATIONAL N.V.                   |
| TIM CELULAR S.A. (mobile telephony operator)  | SAO PAULO (BRAZIL)               | BRL | 8,434,645,238  | 100.0000 |         | TIM PARTICIPAÇÕES S.A.                   |
| TIM NORDESTE S.A. (mobile telephony operator)   | JABOATÃO DOS GUARARAPES (BRAZIL) | BRL | 1,585,220,696  | 100.0000 |         | TIM CELULAR S.A.                         |
| TIM PARTICIPACOES S.A. (holding company)  | RIO DE JANEIRO (BRAZIL)          | BRL | 7,512,709,900  | 69.6703  | 81.2059 | TIM BRASIL SERVIÇOS E PARTICIPAÇÕES S.A. |

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| Name  | Financial Statements |          | Notes To Consolidated Financial Statements |                   |                    |  |
|---|----------------------|----------|--|-------------------|--------------------|--|
|   | Head Office          | Currency | Share Capital                              | % ownership       | % of voting rights | Held by  |
| <b>MEDIA</b>  |                      |          |  |                   |                    |  |
| BEIGUA S.r.l.<br>(purchase, sale, management and maintenance of installation for the repair and distribution of radio and TV broadcasting)                      | ROME<br>(ITALY)      | EUR      | 51,480                                     | 51.0004           |                    | TI MEDIA BROADCASTING S.r.l.                         |
| GIALLO VIAGGI.IT S.r.l. (in liquidation)<br>(research, design, development, production of information and telematic products for tourism)                       | MILAN<br>(ITALY)     | EUR      | 10,000                                     | 100.0000          |                    | TELECOM ITALIA MEDIA S.p.A.                          |
| HOLDING MEDIA E COMUNICAZIONE PUBBLICITA S.r.l. (in liquidation)<br><br>(purchase/sale of ad space and management of advertising on radio/TV stations/channels) | ROME<br><br>(ITALY)  | EUR      | 10,000                                     | 100.0000          |                    | HOLDING MEDIA E COMUNICAZIONE HMC S.p.A.             |
| HOLDING MEDIA E COMUNICAZIONE H.M.C. S.p.A.<br><br>(production, marketing on TV and press)  | ROME<br><br>(ITALY)  | EUR      | 5,064,000                                  | 100.0000          |                    | TELECOM ITALIA MEDIA S.p.A.                          |
| MTV ITALIA S.r.l.<br>(services in the field of radio and TV broadcasting, production and sale of radio, TV and cinema programs)                                 | ROME<br>(ITALY)      | EUR      | 12,151,928                                 | 51.0000           |                    | TELECOM ITALIA MEDIA S.p.A.                          |
| MTV PUBBLICITA S.r.l.<br>(advertising agency)   | MILAN<br>(ITALY)     | EUR      | 10,400                                     | 100.0000          |                    | MTV ITALIA S.r.l.                                    |
| SCS COMUNICAZIONE INTEGRATA S.p.A. (in liquidation)<br><br>(marketing and communication consulting)   | ROME<br><br>(ITALY)  | EUR      | 600,000                                    | 100.0000          |                    | TELECOM ITALIA MEDIA S.p.A.                          |
| TELECOM ITALIA MEDIA S.p.A.<br>(management of all activities connected with the handling of information)  | ROME<br>(ITALY)      | EUR      | 100,510,259                                | 65.7069<br>2.2471 | 66.7962<br>2.2846  | TELECOM ITALIA S.p.A.<br>TELECOM ITALIA FINANCE S.A. |
| TELECOM MEDIA NEWS S.p.A.<br>(multimedia journalistic information)  | ROME<br>(ITALY)      | EUR      | 120,000                                    | 100.0000          |                    | TELECOM ITALIA MEDIA S.p.A.                          |
| TI MEDIA BROADCASTING S.r.l.<br>(purchase, sale, management and maintenance of installation for the repair and distribution of radio and TV broadcasting)       | ROME<br>(ITALY)      | EUR      | 15,000,000                                 | 100.0000          |                    | TELECOM ITALIA MEDIA S.p.A.                          |

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**OLIVETTI**

|  |                             |     |           |                    |  |
|--|-----------------------------|-----|-----------|--------------------|--|
| ADVALSO S.p.A.<br>(planning, production and servicing of telecommunication services and product)                       | IVREA<br><br>(TURIN ITALY)  | EUR | 500,000   | 100.0000           | OLIVETTI S.p.A.                          |
| CONSORZIO MAEL<br>(participation in bids and competitions held by public and private entities)                         | ROME<br>(ITALY)             | EUR | 52,000    | 60.0000<br>40.0000 | OLIVETTI S.p.A.<br>TIEMME SISTEMI S.r.l. |
| DIASPRON DO BRASIL S.A. (in liquidation)<br>(manufacture and export of typewriters and printers)                       | SAO PAULO<br>(BRAZIL)       | BRL | 5,135,417 | 100.0000           | OLIVETTI DO BRASIL S.A.                  |
| MULTIDATA S/A ELETRONICA INDUSTRIA E COMERCIO (in liquidation)<br>(manufacture and export of typewriters and printers) | MANAUS<br><br>(BRAZIL)      | BRL | 5,583,350 | 100.0000           | OLIVETTI DO BRASIL S.A.                  |
| OLIVETTI ARGENTINA S.A.C.e.I. (in liquidation)<br>(sale and maintenance of office equipment)                           | BUENOS AIRES<br>(ARGENTINA) | ARS | 7,590,000 | 100.0000           | OLIVETTI INTERNATIONAL B.V.              |

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| Name   | Financial Statements                   |          |               | Notes To Consolidated Financial Statements |                    |  |
|--|--|----------|---------------|--|--------------------|--|
|  | Head Office                            | Currency | Share Capital | % ownership                                | % of voting rights | Held by  |
| OLIVETTI AUSTRIA G.m.b.H<br>(sale of office equipment and accessories)   | VIENNA<br>(AUSTRIA)                    | EUR      | 36,336        | 100.0000                                   |                    | OLIVETTI INTERNATIONAL B.V.  |
| OLIVETTI CHILE S.A. (in liquidation)<br><br>(sale and maintenance of office equipment, accessories and software) | SANTIAGO<br><br>(CHILE)                | CLP      | 2,574,015,843 | 100.0000                                   |                    | OLIVETTI INTERNATIONAL B.V.  |
| OLIVETTI COLOMBIANA S.A. (in liquidation)<br><br>(sale of office and industrial equipment)                       | BOGOTA<br><br>(COLOMBIA)               | COP      | 2,500,000,000 | 90.5288<br><br>9.4700<br><br>0.0001        |                    | OLIVETTI INTERNATIONAL B.V.<br><br>OLIVETTI S.p.A.<br><br>OLIVETTI CHILE S.A. (in liquidation) |
| OLIVETTI DE PUERTO RICO, Inc.<br>(office equipment in the United States and Central America)                     | SAN JUAN<br>(PUERTO RICO)              | USD      | 1,000         | 100.0000                                   |                    | OLIVETTI INTERNATIONAL B.V.  |
| OLIVETTI DEUTSCHLAND GmbH<br>(sale of office equipment and holding company)                                      | NURNBERG<br>(GERMANY)                  | EUR      | 25,600,000    | 100.0000                                   |                    | OLIVETTI INTERNATIONAL B.V.  |
| OLIVETTI DO BRASIL S.A.<br>(manufacture and sale of typewriters, accessories, spare parts and assistance)        | SAO PAULO<br>(BRAZIL)                  | BRL      | 111,660,625   | 96.6446<br>3.3554                          |                    | OLIVETTI INTERNATIONAL B.V.<br>OLIVETTI MEXICANA S.A. (in liquidation)                         |
| OLIVETTI ENGINEERING S.A.<br>(product research and development based on ink-jet technology)                      | YVERDON LES BAINS<br><br>(SWITZERLAND) | CHF      | 100,000       | 100.0000                                   |                    | OLIVETTI I-JET S.p.A.  |
| OLIVETTI ESPANA S.A.<br>(sale and maintenance of office equipment, consulting and telematic network management)  | BARCELONA<br>(SPAIN)                   | EUR      | 1,229,309     | 99.9863                                    |                    | OLIVETTI INTERNATIONAL B.V.  |
| OLIVETTI FRANCE S.A.<br>(sale of office equipment and software)  | PUTEAUX<br>(FRANCE)                    | EUR      | 2,200,000     | 100.0000                                   |                    | OLIVETTI INTERNATIONAL B.V.  |
| OLIVETTI I-JET S.p.A.<br>(manufacture and sale of products and accessories for office equipment)                 | ARNAD<br>(AOSTA ITALY)                 | EUR      | 15,000,000    | 100.0000                                   |                    | OLIVETTI S.p.A.  |
| OLIVETTI INTERNATIONAL B.V.<br>(holding company)   | AMSTERDAM<br>(HOLLAND)                 | EUR      | 355,027,092   | 100.0000                                   |                    | OLIVETTI S.p.A.  |



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|   |                             |     |             |          |                             |
|---|-----------------------------|-----|-------------|----------|-----------------------------|
| OLIVETTI MEXICANA S.A.<br>(in liquidation)  | MEXICO CITY<br><br>(MEXICO) | MXN | 34,637,065  | 99.9999  | OLIVETTI INTERNATIONAL B.V. |
| (manufacture and sale, import-export of typewriters, adding machines, accessories and spare parts, technical assistance services) |                             |     |             | 0.0001   | OLIVETTI S.p.A.             |
| OLIVETTI S.p.A.<br>(manufacture and sale of products and accessories for office equipment)  | IVREA<br>(TURIN ITALY)      | EUR | 154,000,000 | 100.0000 | TELECOM ITALIA S.p.A.       |
| OLIVETTI TECNOST NEDERLAND B.V. (in liquidation)  | LEIDERDORP<br><br>(HOLLAND) | EUR | 6,468,280   | 100.0000 | OLIVETTI INTERNATIONAL B.V. |
| (sale of office equipment and accessories)  |                             |     |             |          |                             |
| OLIVETTI UK Ltd.<br>(sale of office equipment)  | MILTON KEYNES<br>(UK)       | GBP | 6,295,712   | 100.0000 | OLIVETTI INTERNATIONAL B.V. |
| TIEMME SISTEMI S.r.l.<br>(electric, electromechanical, electronic equipment and related systems)                                  | CARSOLI<br>(L AQUILA ITALY) | EUR | 1,040,000   | 100.0000 | OLIVETTI S.p.A.             |

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| Name  | Financial Statements    |          |               | Notes To Consolidated Financial Statements |                    |   |
|---|-------------------------|----------|---------------|--|--------------------|---|
|   | Head Office             | Currency | Share Capital | % ownership                                | % of voting rights | Held by   |
| TIESSE S.c.p.A.<br>(installation and assistance for electromechanical, electronic, computer, telematic and telecommunications equipment)    | ROME<br>(ITALY)         | EUR      | 103,292       | 42.0000<br>19.0000                         |                    | OLIVETTI S.p.A.<br>TIEMME SISTEMI S.r.l.                    |
| TOP SERVICE S.p.A.<br>(electronic diagnostics and repairs of computer products)   | MODUGNO<br>(BARI ITALY) | EUR      | 293,618       | 91.2069                                    |                    | OLIVETTI S.p.A.   |
| <b>OTHER ACTIVITIES</b>   |                         |          |               |  |                    |   |
| ASCAI SERVIZI S.r.l. (in liquidation)<br>(strategy and communication processes promotion)   | ROME<br>(ITALY)         | EUR      | 73,337        | 64.9599                                    |                    | SAIAT SOCIETA<br>ATTIVITA INTERMEDIE AUSILIARIE<br>TLC P.A. |
| DATACOM S.A.<br>(data transmission services)  | LA PAZ<br>(BOLIVIA)     | BOB      | 66,938,200    | 99.9991                                    |                    | ENTEL BOLIVIA   |
| DOMUS ACADEMY S.p.A.<br>(specialized design courses)  | MILAN<br>(ITALY)        | EUR      | 140,000       | 67.3336                                    |                    | TELECOM ITALIA S.p.A.                                       |
| EMSA Servizi S.p.A. (in liquidation)<br>(real estate services management)   | ROME<br>(ITALY)         | EUR      | 5,000,000     | 100.0000                                   |                    | TELECOM ITALIA S.p.A.                                       |
| ENTEL S.A.-EMPRESA NACIONAL DE TELECOMUNICACIONES<br><br>(long-distance telecommunications services, mobile and data transmission services) | LA PAZ<br>(BOLIVIA)     | BOB      | 1,280,898,800 | 50.0000                                    |                    | ETI-EURO<br>TELECOMINTERNATIONAL N.V.                       |
| ETI EURO TELECOM INTERNATIONALAMSTERDAM N.V.<br><br>(holding company)   | (HOLLAND)               | EUR      | 50,050        | 100.0000                                   |                    | ICH INTERNATIONAL<br>COMMUNICATION HOLDING N.V.             |
| ICH INTERNATIONAL COMMUNICATION HOLDING N.V.<br><br>(holding company)   | AMSTERDAM<br>(HOLLAND)  | EUR      | 50,000        | 100.0000                                   |                    | TELECOM ITALIA INTERNATIONAL<br>N.V.                        |
| IRIDIUM ITALIA S.p.A. (in liquidation)<br><br>(satellite telecommunications services)   | ROME<br>(ITALY)         | EUR      | 2,575,000     | 65.0000                                    |                    | TELECOM ITALIA S.p.A.                                       |
| NETESI S.p.A. (in liquidation)<br>(telecommunications and multimedia services)  | MILAN<br>(ITALY)        | EUR      | 434,715       | 100.0000                                   |                    | TELECOM ITALIA S.p.A.                                       |

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|   |                            |     |             |          |                               |
|---|----------------------------|-----|-------------|----------|-------------------------------|
| O&B COSTRUZIONI GENERALI S.r.l.<br>(in liquidation)<br><br>(real estate purchases, exchanges and sales) | IVREA<br><br>(TURIN ITALY) | EUR | 100,000     | 50.1000  | OLIVETTI MULTISERVICES S.p.A. |
| OFI CONSULTING S.r.l.<br>(administrative consulting)  | IVREA<br>(TURIN ITALY)     | EUR | 95,000      | 100.0000 | TELECOM ITALIA S.p.A.         |
| OLIVETTI GESTIONI IVREA S.p.A. (in liquidation)<br>(real estate services)                               | IVREA<br>(TURIN ITALY)     | EUR | 1,300,000   | 100.0000 | TELECOM ITALIA S.p.A.         |
| OLIVETTI HOLDING B.V.<br>(holding company)  | AMSTERDAM<br>(HOLLAND)     | EUR | 15,882,770  | 100.0000 | TELECOM ITALIA FINANCE S.A.   |
| OLIVETTI MULTISERVICES S.p.A.<br>(real estate management)   | MILAN<br>(ITALY)           | EUR | 20.337.161  | 100.0000 | TELECOM ITALIA S.p.A.         |
| OLIVETTI SYSTEMS TECHNOLOGY CORPORATION (in liquidation)<br><br>(real estate management)                | YOKOHAMA<br><br>(JAPAN)    | JPY | 100,000,000 | 100.0000 | TELECOM ITALIA FINANCE S.A.   |
| OMS HOLDING B.V. (in liquidation)<br>(financing)  | AMSTERDAM<br>(HOLLAND)     | EUR | 20,000      | 100.0000 | OLIVETTI MULTISERVICES S.p.A. |
| PROGETTO ITALIA S.p.A.<br>(development and improvement of the Telecom Italia brand)                     | MILAN<br>(ITALY)           | EUR | 1,000,000   | 100.0000 | TELECOM ITALIA S.p.A.         |

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| Name   | Financial Statements        |          |               | Notes To Consolidated Financial Statements |                    |  |
|--|-----------------------------|----------|---------------|--|--------------------|--|
|  | Head Office                 | Currency | Share Capital | % ownership                                | % of voting rights | Held by  |
| SAIAT SOCIETA' ATTIVITA INTERMEDIE AUSILIARIE TLC P.A.<br>(financing)                                  | TURIN<br>(ITALY)            | EUR      | 35,745,120    | 100.0000                                   |                    | TELECOM ITALIA S.p.A.                                |
| SATURN VENTURE PARTNERS LLC<br>(financing)   | DELAWARE<br>(USA)           | USD      | 25,806,100    | 56.9600<br>17.8482                         |                    | TELECOM ITALIA LAB SA<br>TELECOM ITALIA S.p.A.       |
| TECNOSERVIZI MOBILI S.r.l.<br>(management of movable assets)   | ROME<br>(ITALY)             | EUR      | 26,000        | 51.0000                                    |                    | TELECOM ITALIA S.p.A.                                |
| TECO SOFT ARGENTINA S.A. (in liquidation)<br>(design. development and sale of software)                | BUENOS AIRES<br>(ARGENTINA) | ARS      | 12,000        | 99.9917                                    |                    | TELECOM ITALIA S.p.A.                                |
| TELECOM ITALIA AMERICA LATINA S.A.<br>(services and relations office)                                  | SAO PAULO<br>(BRAZIL)       | BRL      | 43,614,072    | 99.9996                                    |                    | TELECOM ITALIA S.p.A.                                |
| TELECOM ITALIA AUDIT AND COMPLIANCE SERVICES SCARL<br>(internal auditing for the Telecom Italia Group) | MILAN<br>(ITALY)            | EUR      | 2,750,000     | 81.8182<br>18.1818                         |                    | TELECOM ITALIA S.p.A.<br>TELECOM ITALIA MEDIA S.p.A. |
| TELECOM ITALIA CAPITAL S.A.<br>(financing)   | LUXEMBOURG<br>(LUXEMBOURG)  | EUR      | 2,336,000     | 99.9999<br>0.0001                          |                    | TELECOM ITALIA S.p.A.<br>TELECOM ITALIA FINANCE S.A. |
| TELECOM ITALIA FINANCE S.A.<br>(financing)   | LUXEMBOURG<br>(LUXEMBOURG)  | EUR      | 542,090,241   | 100.0000                                   |                    | TELECOM ITALIA S.p.A.                                |
| TELECOM ITALIA INTERNATIONAL N.V.<br>(holding company)   | AMSTERDAM<br>(HOLLAND)      | EUR      | 2,399,483,000 | 100.0000                                   |                    | TELECOM ITALIA S.p.A.                                |
| TELECOM ITALIA LAB S.A.<br>(holding company)   | LUXEMBOURG<br>(LUXEMBOURG)  | USD      | 163,870       | 99.9939<br>0.0061                          |                    | TELECOM ITALIA S.p.A.<br>TELECOM ITALIA FINANCE S.A. |
| TELENERGIA S.r.l.<br>(import, export, purchase, sale and exchange of electrical energy)                | ROME<br>(ITALY)             | EUR      | 50,000        | 100.0000                                   |                    | TELECOM ITALIA S.p.A.                                |
| TELSI Unlimited<br>(financing company)   | LONDON<br>(UK)              | GBP      | 499,661,807   | 100.0000                                   |                    | TELECOM ITALIA FINANCE S.A.                          |

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|  |                           |     |             |                        |  |
|--|---------------------------|-----|-------------|------------------------|--|
| TELSY ELETTRONICA E<br>TELECOMUNICAZIONI S.p.A.<br><br>(manufacturing and sale of systems for<br>encrypted telecommunications) | TURIN<br><br>(ITALY)      | EUR | 390,000     | 100.0000               | TELECOM ITALIA S.p.A.  |
| TIAUDIT LATAM S.A.<br><br>(internal auditing)  | SAO PAULO<br><br>(BRAZIL) | BRL | 1,500,000   | 69.9996<br><br>30.0000 | TELECOM ITALIA AUDIT AND<br>COMPLIANCE SERVICES SCARL<br><br>TIM BRASIL SERVICOS E<br>PARTICIPACOES S.A. |
| TIM INTERNATIONAL N.V.<br>(holding company)  | AMSTERDAM<br>(HOLLAND)    | EUR | 555,431,000 | 100.0000               | TELECOM ITALIA S.p.A.  |
| TRAINET S.p.A. (in liquidation)<br>(development, operation and sales of<br>teleteaching systems)                               | ROME<br>(ITALY)           | EUR | 674,446     | 100.0000               | TELECOM ITALIA S.p.A.  |

**Telecom Italia Group**

**List of companies accounted for using the equity method**

| <b>Name</b>  | <b>Head Office</b> | <b>Currency</b> | <b>Share<br/>Capital</b> | <b>%<br/>ownership</b> | <b>% of<br/>voting<br/>rights</b> | <b>Held by</b>                                       |
|--|--------------------|-----------------|--------------------------|------------------------|-----------------------------------|--|
| ARCHEO S.p.A. (in liquidation)<br>(services)             | BARI<br>(ITALY)    | EUR             | 464,400                  | 25.0000                |                                   | OFI CONSULTING S.r.l.                                |
| AREE URBANE S.r.l.<br>(real estate)                      | MILAN<br>(ITALY)   | EUR             | 307,717                  | 31.6508<br>0.9700      |                                   | TELECOM ITALIA S.p.A.<br>TELECOM ITALIA MEDIA S.p.A. |
| ASSCOM INSURANCE BROKERS S.r.l.<br>(insurance mediation) | MILAN<br>(ITALY)   | EUR             | 100,000                  | 20.0000                |                                   | TELECOM ITALIA S.p.A.                                |

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| Financial Statements   |   |          | Notes To Consolidated Financial Statements |             |                    |                                   |
|--|---|----------|--|-------------|--------------------|-----------------------------------|
| Name   | Head Office                             | Currency | Share Capital                              | % ownership | % of voting rights | Held by                           |
| BALTEA S.r.l.<br>(manufacture and sale of office equipment and computer and telecommunications services)         | IVREA<br>(TURIN<br>ITALY)               | EUR      | 2,220,000                                  | 49.0000     |                    | OLIVETTI S.p.A.                   |
| BROAD BAND SERVICE S.A.<br>(production and sales of multimedia services)   | SERRAVALLE<br>REPUBLIC OF<br>SAN MARINO | EUR      | 258,000                                    | 20.0000     |                    | TELECOM ITALIA SAN MARINO S.p.A.  |
| CONSORZIO E O (in liquidation)<br>(professional training)  | ROME<br>(ITALY)                         | EUR      | 19,107                                     | 50.0000     |                    | TELECOM ITALIA S.p.A.             |
| CONSORZIO S.I.A.R.C. (in liquidation)<br><br>(supply of information products and services)                       | NAPLES<br><br>(ITALY)                   | EUR      | 25,821                                     | 30.0000     |                    | TELECOM ITALIA S.p.A.             |
| CONSORZIO SCUOLA SUPERIORE ALTA FORMAZIONE UNIVERSITARIA FEDERICO II (in liquidation)<br>(professional training) | NAPLES<br>(ITALY)                       | EUR      | 127,500                                    | 20.0000     |                    | TELECOM ITALIA S.p.A.             |
| CONSORZIO TURISTEL<br>(online tourism services)  | ROME<br>(ITALY)                         | EUR      | 77,460                                     | 33.3333     |                    | TELECOM ITALIA S.p.A.             |
| Empresa de Telecomunicaciones de Cuba S.A. ETEC-SA<br><br>(telecommunications services)                          | HAVANA<br><br>(CUBA)                    | USD      | 1,749,313,080                              | 27.0030     |                    | TELECOM ITALIA INTERNATIONAL N.V. |
| IM.SER S.p.A.<br>(real estate management)  | TURIN<br>(ITALY)                        | EUR      | 367,200                                    | 40.0000     |                    | TELECOM ITALIA S.p.A.             |
| IN.VA. S.p.A.<br>(information systems)   | AOSTA<br>(ITALY)                        | EUR      | 520,000                                    | 40.0000     |                    | TELECOM ITALIA S.p.A.             |
| INTERCALL HELLAS S.A.<br>(sale of prepaid telephone cards)   | ATHENS<br>(GREECE)                      | EUR      | 496,696                                    | 29.4099     |                    | INTERCALL S.A.                    |
| ITALTEL GROUP S.p.A.<br>(holding company)  | MILAN<br>(ITALY)                        | EUR      | 115,459,344                                | 19.3733     |                    | TELECOM ITALIA FINANCE S.A.       |
| LI.SIT. LOMBARDIA INTEGRATA SERVIZI INFOTELEMATICI PER IL TERRITORIO S.p.A.                                      | MILAN<br><br>(ITALY)                    | EUR      | 6,500,000                                  | 24.2000     |                    | TELECOM ITALIA S.p.A.             |

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(information, TLC services and products for the local public administration)

|   |                         |     |            |         |                            |
|---|-------------------------|-----|------------|---------|----------------------------|
| LUNA ROSSA CHALLENGE 2007 S.L.<br><br>(promotion, organization of sailboat races include the America's Cup) | VALENCIA<br><br>(SPAIN) | EUR | 4,000,000  | 49.0000 | TELECOM ITALIA S.p.A.      |
| LUNA ROSSA TRADEMARK s.a.r.l.<br>(purchase, management, development of intellectual property rights)        | LUXEMBOURG              | EUR | 20,000,000 | 49.0000 | TELECOM ITALIA S.p.A.      |
| MIAECONOMIA S.r.l.<br>(publishing in the field of personal finance)   | ROME<br>(ITALY)         | EUR | 1,000,000  | 30.0000 | MATRIX S.p.A.              |
| MOVENDA S.p.A.<br>(technological platforms for the development of mobile Internet services)                 | ROME<br>(ITALY)         | EUR | 133,333    | 24.9998 | TELECOM ITALIA LAB SA      |
| NAUTILUS S.c.a.r.l.<br>(professional training)  | ROME<br><br>(ITALY)     | EUR | 30,000     | 20.0000 | MEDITERRANEAN NAUTILUS LTD |

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|--|---------------------------------|----------|--|------------------------|--------------------|--|
| Name   | Head Office                     | Currency | Share Capital                              | % ownership            | % of voting rights | Held by  |
| NAVIGATE CONSORTIUM<br>(terrestrial and satellite network integration)   | MILAN<br>(ITALY)                | EUR      | 582,716                                    | 20.0000                |                    | TELECOM ITALIA S.p.A.  |
| NORDCOM S.p.A.<br>(application service provider)   | MILAN<br>(ITALY)                | EUR      | 5,000,000                                  | 42.0000                |                    | TELECOM ITALIA S.p.A.  |
| OCN-TRADING S.r.l. (in liquidation)<br><br>(trading company)   | IVREA<br><br>(TURIN ITALY)      | EUR      | 40,800                                     | 40.0000                |                    | TELECOM ITALIA S.p.A.  |
| PERSEO S.r.l.<br>(purchase, sale, exchange, rent, administration, maintenance of movable goods registered for any use and destination) | MILAN<br>(ITALY)                | EUR      | 20,000                                     | 50.0000                |                    | TELECOM ITALIA S.p.A.  |
| RETAIL NETWORK SERVICES B.V.<br>(holding company)  | AMSTERDAM<br>(HOLLAND)          | EUR      | 15,129,484                                 | 37.2691                |                    | OLIVETTI S.p.A.  |
| SHARED SERVICE CENTER SCARL<br>(planning, design, installation running of computer services)   | MILAN<br>(ITALY)                | EUR      | 1,756,612                                  | 45.4545<br>4.5455      |                    | TELECOM ITALIA S.p.A.<br>OLIVETTI S.p.A.                       |
| SIEMENS INFORMATICA S.p.A.<br>(supply of innovating solutions in the field of electronic and mobile business)                          | MILAN<br>(ITALY)                | EUR      | 6,192,000                                  | 49.0000                |                    | TELECOM ITALIA S.p.A.  |
| SOFORA TELECOMUNICACIONES S.A.<br><br>(holding company)  | BUENOS AIRES<br><br>(ARGENTINA) | ARS      | 439,702,000                                | 32.5000<br><br>17.5000 |                    | TELECOM ITALIA S.p.A.<br><br>TELECOM ITALIA INTERNATIONAL N.V. |
| TELBIOS S.p.A.<br>(technological services supporting the health sector)  | MILAN<br>(ITALY)                | EUR      | 2,458,330                                  | 31.0345                |                    | TELECOM ITALIA S.p.A.  |
| TELEGONO S.r.l.<br>(real estate management)  | ROME<br>(ITALY)                 | EUR      | 1,000,000                                  | 40.0000                |                    | TELECOM ITALIA S.p.A.  |
| TELELEASING LEASING DI TELECOMUNICAZIONI E GENERALE S.p.A.<br><br>(financial leasing of real estate and other assets)                  | MILAN<br><br>(ITALY)            | EUR      | 9,500,000                                  | 20.0000                |                    | SAIAT SOCIETA ATTIVITA INTERMEDIE AUSILIARIE TLC P.A.          |



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|  |                                |     |           |                   |  |
|--|--------------------------------|-----|-----------|-------------------|--|
| TIGLIO I S.r.l.<br>(real estate management)                            | MILAN<br>(ITALY)               | EUR | 5,255,704 | 45.6991<br>2.1027 | TELECOM ITALIA S.p.A.<br>TELECOM ITALIA MEDIA S.p.A. |
| TIGLIO II S.r.l.<br>(real estate management)                           | MILAN<br>(ITALY)               | EUR | 6,185,288 | 49.4707           | TELECOM ITALIA S.p.A.                                |
| UBA NET S.A. (in liquidation)<br>(teleteaching systems)                | BUENOS<br>AIRES<br>(ARGENTINA) | ARS | 12,000    | 50.0000           | TRAINET S.p.A. (in liquidation)                      |
| WEMACOM TELEKOMMUNIKATION<br>GmbH<br><br>(telecommunications services) | SCHWERIN<br><br>(GERMANY)      | EUR | 60,000    | 25.0000           | HANSENET<br>TELEKOMMUNIKATION GmbH                   |

**Telecom Italia Group**

**Other significant investments in accordance with Consob resolution No. 11971 dated May 14, 1999**

| <b>Name</b>  | <b>Head Office</b>  | <b>Currency</b> | <b>Share<br/>Capital</b> | <b>%<br/>ownership</b> | <b>% of<br/>voting<br/>rights</b> | <b>Held by</b>        |
|--|---------------------|-----------------|--------------------------|------------------------|-----------------------------------|-----------------------|
| ATESIA Telemarketing Comunicazione<br>Telefonica e Ricerche di Mercato S.p.A.<br><br>(telemarketing) | ROME<br><br>(ITALY) | EUR             | 3,150,406                | 19.9000                |                                   | TELECOM ITALIA S.p.A. |
| CEFRIEL S.r.l.<br>(professional training)  | MILAN<br>(ITALY)    | EUR             | 100,000                  | 11.6000                |                                   | TELECOM ITALIA S.p.A. |

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| Name  | Financial Statements            |          |               | Notes To Consolidated Financial Statements |                    |                             |
|---|---------------------------------|----------|---------------|--|--------------------|-----------------------------|
|   | Head Office                     | Currency | Share Capital | % ownership                                | % of voting rights | Held by                     |
| CELL TEL S.p.A.<br>(telecommunications equipment, plant and systems)                              | IVREA<br>(TURIN ITALY)          | EUR      | 500,000       | 15.0000                                    |                    | OLIVETTI S.p.A.             |
| FIN.PRIV. S.r.l.<br>(financing)   | MILAN<br>(ITALY)                | EUR      | 20,000        | 14.2900                                    |                    | TELECOM ITALIA S.p.A.       |
| IFM INFOMASTER S.p.A.<br>(planning and development of call center solutions)                      | GENOA<br>(ITALY)                | EUR      | 161,765       | 12.0000                                    |                    | TELECOM ITALIA LAB S.A.     |
| INNOVIS S.p.A.<br>(computer, online and telecommunications equipments and services)               | IVREA<br>(TURIN ITALY)          | EUR      | 325,000       | 15.0000                                    |                    | OLIVETTI S.p.A.             |
| INSULA S.p.A.<br>(telecommunications services)  | VENICE MESTRE<br>(ITALY)        | EUR      | 2,064,000     | 12.0000                                    |                    | TELECOM ITALIA S.p.A.       |
| ITALBIZ.COM Inc.<br>(Internet services)   | CALIFORNIA<br><br>(USA)         | USD      | 4,720         | 19.5000                                    |                    | TELECOM ITALIA MEDIA S.p.A. |
| LEGACY LLH LIMITED (EX LEISURE LINK ltd)<br><br>(manufacture of gaming and leisure-time machines) | STAFFORDSHIRE<br><br>(UK)       | GBP      | 7,809,179     | 11.4700                                    |                    | TELECOM ITALIA FINANCE S.A. |
| NEW SATELLITE RADIO S.r.l.<br>(production and realization of radio-tv channel and program)        | MILAN<br>(ITALY)                | EUR      | 10,000        | 12.7200                                    |                    | TELECOM ITALIA S.p.A.       |
| OGER TELECOM LIMITED<br>(holding company)   | DUBAY<br>(UNITED ARAB EMIRATES) | USD      | 4,343,436,360 | 10.3600                                    |                    | TIM INTERNATIONAL N.V.      |
| PIEDMONT INTERNATIONAL S.A.<br><br>(financing)  | LUXEMBOURG<br><br>(LUXEMBOURG)  | USD      | 10,507,500    | 17.1300                                    | 10.3000            | TELECOM ITALIA FINANCE S.A. |
| TWICE SIM S.p.A.<br>(investment services)   | MILAN<br>(ITALY)                | EUR      | 8,450,000     | 14.2300                                    |                    | TELECOM ITALIA MEDIA S.p.A. |
| USABLENET INC<br>(development of software for the analysis of web site usability)                 | DELAWARE<br>(USA)               | USD      | 4             | 18.1081                                    |                    | TELECOM ITALIA LAB SA       |



**Table of Contents****Financial Statements****Notes To Consolidated Financial Statements****NOTE 46 RECONCILIATION OF IFRS AS ADOPTED BY THE EU TO U.S. GAAP**

The Consolidated Financial Statements of the Group have been prepared in accordance with IFRS, which differ in certain respects from generally accepted accounting principles in the United States (U.S. GAAP).

Certain amounts in the presentation of the 2005 and 2004 reconciliations of Net income for the year and Equity, from IFRS to U.S. GAAP have been reclassified to conform to the 2006 presentation.

Application of U.S. GAAP would have affected net income for each of the years ended December 31, 2006, 2005 and 2004 and equity as of December 31, 2006 and 2005 to the extent described below.

|   | Year ended December 31, |                |              |
|---|-------------------------|----------------|--------------|
|   | 2006                    | 2005           | 2004         |
|   | (millions of Euro)      |                |              |
| <b>RECONCILIATION OF NET INCOME FOR THE YEAR FROM IFRS TO U.S. GAAP</b>           |                         |                |              |
| Net income for the year as reported in the consolidated statements of income      | 3,003                   | 3,690          | 2,834        |
| Minority Interests  | 11                      | (474)          | (1,019)      |
| <b>Net income attributable to equity holders of the Parent under IFRS</b>         | <b>A) 3,014</b>         | <b>3,216</b>   | <b>1,815</b> |
| <b>U.S. GAAP reconciling adjustments:</b>   |                         |                |              |
| 1. Purchase method of accounting, reversal of amortization and other adjustments: |                         |                |              |
| (a) Goodwill  |                         |                | 438          |
| (b) Other intangible assets with an indefinite life                               | (5)                     |                |              |
| (c) Intangible assets with a finite life  | (1,512)                 | (1,387)        | (1,026)      |
| (d) Tangible assets   | (168)                   | (404)          | 48           |
| (e) Other   | 78                      | 90             | 136          |
|   | (1,607)                 | (1,701)        | (404)        |
| 2. Reversal of revaluation on tangible assets                                     | 39                      | 85             | 7            |
| 3. Capitalization of interest   | (43)                    | (26)           | (60)         |
| 4. Sale of real estate properties   | (23)                    | (44)           | 44           |
| 5. Convertible notes/bonds  | 14                      | 12             | 28           |
| 6. Deferred taxes on tax-suspension equity reserves                               |                         | (57)           |              |
| 7. Other  | (287)                   | (3)            | (37)         |
| <b>Total U.S. GAAP reconciling adjustments</b>                                    | <b>B) (1,907)</b>       | <b>(1,734)</b> | <b>(422)</b> |
| <b>Tax effect on reconciling items</b>  | <b>C) 624</b>           | <b>558</b>     | <b>334</b>   |
| <b>Minority Interests on reconciling items</b>                                    | <b>D) 26</b>            | <b>27</b>      | <b>(186)</b> |

|  |                     |                   |                   |                   |
|--|---------------------|-------------------|-------------------|-------------------|
| <b>Total effect of discontinued operations/assets held for sale</b>    | <b>E)</b>           | <b>105</b>        | <b>(175)</b>      |                   |
| <b>Cumulative effect of accounting changes, net of taxes and after</b> |                     |                   |                   |                   |
| <b>Minority Interests</b>  | <b>F)</b>           |                   | <b>47</b>         |                   |
|  |                     | <u>          </u> | <u>          </u> | <u>          </u> |
| <b>Net income in accordance with U.S. GAAP</b>                         | <b>A+B+C+D+E+F)</b> | <b>1,862</b>      | <b>1,939</b>      | <b>1,541</b>      |
|  |                     | <u>          </u> | <u>          </u> | <u>          </u> |

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| Financial Statements  | Notes To Consolidated Financial Statements |                |
|---|--|----------------|
|   | As of December 31,                         |                |
|   | 2006                                       | 2005           |
|   | (millions of Euro)                         |                |
| <b>RECONCILIATION OF EQUITY FROM IFRS TO U.S. GAAP</b>                                    |  |                |
| Equity as reported in the consolidated balance sheets                                     | 27,098                                     | 26,985         |
| Minority Interests  | (1,080)                                    | (1,323)        |
| <b>Equity attributable to equity holders of the Parent under IFRS</b>                     | <b>A) 26,018</b>                           | <b>25,662</b>  |
| <b>U.S. GAAP reconciling adjustments:</b>   |  |                |
| 1. Purchase method of accounting, reversal of amortization and other adjustments:         |  |                |
| (a) Goodwill  | 6,468                                      | 6,227          |
| (b) Other intangible assets with an indefinite life                                       | 3,015                                      | 3,020          |
| (c) Intangible assets with a finite life  | 15,373                                     | 16,887         |
| (d) Tangible assets   | 374  | 542            |
| (e) Other   | (169)                                      | (13)           |
|   | 25,061                                     | 26,663         |
| 2. Reversal of revaluation on tangible assets   | (248)                                      | (284)          |
| 3. Capitalization of interest   | 717  | 752            |
| 4. Sale of real estate properties   | (238)                                      | (215)          |
| 5. Convertible notes/bonds  | (50)                                       | (67)           |
| 6. Deferred taxes on tax-suspension equity reserves                                       | (257)                                      | (257)          |
| 7. Other  | (120)                                      | 199            |
| 8. Discontinued operations/assets held for sale   |  | (105)          |
| <b>Total U.S. GAAP reconciling adjustments</b>  | <b>B) 24,865</b>                           | <b>26,686</b>  |
| <b>Tax effect on reconciling items</b>  | <b>C) (7,078)</b>                          | <b>(7,694)</b> |
| <b>Minority Interests on reconciling items</b>  | <b>D) 18</b>                               | <b>(23)</b>    |
| <b>Cumulative effect of accounting changes, net of taxes and after Minority Interests</b> | <b>E)</b>                                  |                |
| <b>Equity in accordance with U.S. GAAP</b>  | <b>A+B+C+D+E) 43,823</b>                   | <b>44,631</b>  |

**Table of Contents****Financial Statements****Notes To Consolidated Financial Statements****1. PURCHASE METHOD OF ACCOUNTING, REVERSAL OF AMORTIZATION AND OTHER ADJUSTMENTS**

On the adoption of IFRS as of January 1, 2004, Telecom Italia elected not to apply IFRS 3 *Business Combinations* to prior year business combinations as allowed by IFRS 1 *First-time Adoption of International Financial Reporting Standards*. Certain business combinations prior to 2004 (mainly related to the Old Telecom Italia acquisitions that had occurred during the period from 1999 to 2003) had been accounted for as a pooling of interest or on the basis of book values (for both assets acquired and shares issued).

Also, as permitted by IFRS 1 *First-time Adoption of International Financial Reporting Standards*, the carrying value of goodwill under Italian GAAP as of December 31, 2003, was subject to an impairment test at January 1, 2004, (which did not result in the recognition of impairment charges) and carried forward in the opening balance sheet as of January 1, 2004.

Furthermore, under IFRS, for certain transactions which are not within the scope of IFRS 3 *Business Combinations* the following accounting policies have been established:

- acquisition/sale of interests in companies already controlled: in the case of acquisitions, the Group pays the Minority Interests in cash or by new shares and, at the same time, eliminates the relative share of the Minority Interest and records Goodwill equal to the excess of the acquisition cost over the carrying amount of the assets and liabilities acquired. In the case of sales, the difference between the proceeds of disposal of shares and the corresponding carrying amount on consolidation is recognized in the statement of income (*Parent Entity extension method*);
- intragroup transfers of interests in controlled companies which result in a change in the percentage of ownership: the interests transferred remain recorded at historical cost and the gain or loss on the transfer is eliminated in full. The Minority Interests which do not directly take part in the transaction are adjusted to reflect the change in the respective share of equity with a corresponding opposite effect on the equity attributable to the equity holders of the Parent without recognition of any goodwill. Such treatment does not have any impact on net income or total equity.

Under U.S. GAAP, in accordance with Statement of Financial Accounting Standards ( **SFAS** ) 141, *Business Combinations* all acquisitions (including acquisitions of Minority Interests and intragroup transfers of interests in controlled companies) are accounted for using the purchase method. Under this method the transaction is accounted for on the basis of the fair value of the purchase consideration, the assets and liabilities purchased are recorded at fair value and the difference between the fair value of the purchase consideration and the fair value of the Group's share of assets and liabilities acquired is recorded as goodwill.

Under U.S. GAAP goodwill is assessed for impairment at least annually. If indicators of impairment exist during the year, then an impairment review is conducted before the annual review. In accordance with SFAS 142, *Goodwill and Other Intangible Assets*, the first step in the test for impairment of goodwill is to identify potential impairment by comparing the fair value of a reporting unit (which encompasses a wider meaning than cash generating unit adopted by IFRS) with its carrying amount, including goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered impaired and the second part of the test is not considered necessary. If the carrying amount of a reporting unit exceeds its fair value, the second step of the goodwill impairment test is performed to measure the amount of the loss, if any. The second part compares the implied value of the reporting unit's goodwill to the carrying amount of that goodwill. The excess of the carrying value over the implied value is then written-off in the period. Implied value of goodwill is determined in the same manner as the amount of goodwill recognized in a business combination: the assets and liabilities purchased are recorded at fair value and the excess of the fair value of the

purchase consideration over the fair value of the Group's share of assets and liabilities acquired is recorded as goodwill. Impairment losses of goodwill are not reversed.



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The following information provides an overview of the goodwill, and intangible assets under U.S. GAAP.

**(a) Goodwill**

The roll-forward of goodwill by Reporting from January 1, 2004 to December 31, 2006, is as follows:

|   | Wireline           | Domestic<br>Mobile<br>(*) | Brazil<br>Mobile | Media      | Other<br>activities<br>(included<br>Olivetti) | U.S. GAAP<br>Consolidated | IFRS<br>Consolidated |
|---|--------------------|---------------------------|------------------|------------|---|---------------------------|----------------------|
|   | (millions of Euro) |                           |                  |            |   |                           |                      |
| <b>Goodwill as of January 1, 2004</b>                 | <b>24,484</b>      | <b>12,948</b>             |                  | <b>212</b> | <b>183</b>                                    | <b>37,827</b>             | <b>27,472</b>        |
| Acquisitions and disposals, net                       | 3                  | 219                       |                  | 232        | (22)  | 432                       | 134                  |
| Transfer to discontinued operations                   | (55)               | (529)                     |                  | (20)       | (164)   | (768)                     | (146)                |
| Other   | (3)                | (24)                      |                  |            | 10  | (17)                      | (1)                  |
| <b>Goodwill as of December 31, 2004</b>               | <b>24,429</b>      | <b>12,614</b>             |                  | <b>424</b> | <b>7</b>                                      | <b>37,474</b>             | <b>27,459</b>        |
| Acquisitions and disposals, net                       | 251                | 12,057                    |                  | 134        | (7)   | 12,435                    | 16,987               |
| Transfer to discontinued operations                   |                    |                           |                  |            |   |                           | (665)                |
| Reclassification from Media to Wireline               | 413                |                           |                  | (413)      |   |                           |                      |
| Other   | 248                | 50                        |                  |            |   | 298                       | 199                  |
| <b>Goodwill as of December 31, 2005</b>               | <b>25,341</b>      | <b>24,721</b>             |                  | <b>145</b> |   | <b>50,207</b>             | <b>43,980</b>        |
| Acquisitions and disposals, net                       |                    |                           |                  |            |   |                           | (184)                |
| Reclassification to Brazil Mobile                     |                    | (4,422)                   | 4,422            |            |   |                           |                      |
| Other   |                    |                           |                  |            |   |                           | (57)                 |
| <b>Goodwill as of December 31, 2006<br/>U.S. GAAP</b> | <b>25,341</b>      | <b>20,299</b>             | <b>4,422</b>     | <b>145</b> |   | <b>50,207</b>             | <b>43,739</b>        |
| <b>Goodwill as of December 31, 2006 IFRS</b>          | <b>15,364</b>      | <b>26,946</b>             | <b>1,199</b>     | <b>230</b> |   | <b>43,739</b>             |                      |

(\*) At December 31, 2006, the Group revised the Mobile operating segments, separating domestic and Brazilian operations. The column represents Mobile (Italy and Brazil) through December 31, 2006 and Domestic Mobile only from that date.

During 2005, the Group acquired the outstanding Minority Interest in TIM which, as described in Note 3 Business Combinations, Acquisitions of Minority Interests and Transactions between Companies under Common Control, was accounted for under the Parent Entity extension method under IFRS, resulting in the recognition of goodwill in the amount of 16,654 million under IFRS. For U.S. GAAP purposes, the transaction was accounted for as a step acquisition using the purchase method of accounting. The purchase price allocation resulted in the recognition of goodwill of 12,020 million, intangible assets of 8,276 million, consisting mainly of the customer list and TIM brand name. The customer base of approximately 6,200 million is amortized over approximately 12 years, while the brand name has been assigned an indefinite life and is subject to annual impairment testing.

Moreover, as described in Note 3 Business Combinations, Acquisitions of Minority Interests and Transactions between Companies under Common Control, in 2005 the Parent acquired the Internet business from its subsidiary Telecom Italia Media. Such acquisition under IFRS was treated as a transaction among shareholders and the difference between the price paid and the share of the underlying net assets acquired ( 364 million) was included as a movement of equity. Under U.S. GAAP, the acquisition has been accounted for under the purchase method and the excess of the purchase price over the carrying value of the share of net assets acquired was allocated to brand name, customer list and other intangibles for a total amount of approximately 285 million and to goodwill for approximately 83 million. Such goodwill was attributed to the reporting unit Wireline. At the same time, the Group reclassified the carrying value of goodwill attributable to the Internet business from Media to Wireline based on the relative fair value of the Internet activities to the total fair value of the Internet and Media businesses.

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As a result of purchase accounting in 2006 and previous years, the Group has recorded the following intangible assets with indefinite useful lives:

|                            | <u>2006</u>               | <u>2005</u>         |
|----------------------------|---------------------------|---------------------|
|                            | <b>(millions of Euro)</b> |                     |
| Wireline brand name        | 1,283                     | 1,283               |
| Domestic Mobile brand name | 1,680                     | 1,680               |
| Other                      | 52                        | 57                  |
| <b>Total</b>               | <b><u>3,015</u></b>       | <b><u>3,020</u></b> |

**(c) Intangible assets with a finite life**

Amortization expense for the years ended December 31, 2006, 2005 and 2004 was 3,744 million, 3,076 million and 2,618 million, respectively. The following table presents expected amortization of intangible assets with a finite life for each of the next five years based on the carrying values as of December 31, 2006:

|      | <u>(millions of Euro)</u> |
|------|---------------------------|
| 2007 | 3,856                     |
| 2008 | 3,495                     |
| 2009 | 1,806                     |
| 2010 | 1,769                     |
| 2011 | <u>1,767</u>              |

**2. REVERSAL OF REVALUATION ON TANGIBLE ASSETS**

Prior to the adoption of IFRS, under Italian accounting principles ( **Italian GAAP** ), the Group revalued certain tangible assets as required or permitted by specific regulations. As allowed by the IFRS first time adoption, as of January 1, 2004, the Group elected to use the revalued cost at the revaluation date as deemed cost.

U.S. GAAP does not permit the revaluation of tangible assets and requires depreciation based on historical acquisition cost. Consequently, such different accounting treatment resulted in an increase in net income, due to the reversal of the depreciation expense, and a reduction in equity due to the reversal of the net book value of the revalued amount.

### **3. CAPITALIZATION OF INTEREST**

Under IFRS, Telecom Italia has elected not to capitalize interest on assets under construction. U.S. GAAP requires interest to be capitalized on both tangible and intangible assets regardless of whether specific borrowings relate to the project. The capitalized interest is amortized over the remaining useful life of the assets. A large part of the interest capitalized prior to 2004 relates to the UMTS license of TIM which was put into use in 2004 and on which amortization expense has been calculated commencing in 2004. The Group capitalized interest expense of 84 million in 2006, 114 million in 2005 and 57 million in 2004.

### **4. SALE OF REAL ESTATE PROPERTIES**

Through 2006, the Group entered into a series of real estate transactions that involved IM.SER, Tiglio I, Tiglio II, Pirelli and other Group related parties.

Under IFRS such transactions have been recorded in accordance with the finance method in that the present value of the contractually provided payments approximates the fair value of the properties under lease, except for land which, in absence of a contractual favorable purchase option, was treated as an operating lease.

Such accounting treatment was also followed under U.S. GAAP except for lease contracts relating to land which were generally treated as finance leases.

Furthermore, during 2005 and 2006, Telecom Italia carried out a series of transactions in the context of the reorganization of the physical space occupied by network equipment to gradually free part of the buildings used

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for such equipment. Such project ( **Magnum Project** ) involved the sale of more than 1,300 properties for a total amount of approximately 1 billion. Under IFRS, these transactions generated capital gains, net of incidental charges of 264 million in 2005 and 135 million in 2006. For further details see Note 7 Tangible Assets (Owned and under Finance Leases) .

Under U.S. GAAP, the related assets had been subject to purchase accounting adjustments recorded under the reconciling difference at 46.1.(d) above. As a result, of the disposal of such assets, there has been a reduction in the purchase price adjustment for the real estate assets of 174 million in 2006 and 366 million in 2005 with a corresponding reduction in pre-tax income.

**5. CONVERTIBLE NOTES/BONDS**

Under IFRS, compound financial instruments represented by notes and bonds convertible into shares of the issuer (convertible bonds) are recognized by bifurcating the debt and the call option: the debt is included in financial liabilities under the amortized cost method while the call option value, computed as the difference between the fair value of the debt and the nominal value of the financial instrument, is classified in a specific equity reserve.

Under U.S. GAAP, convertible notes and bonds are recognized as debt. The different accounting treatment resulted in a decrease of equity and an increase in liabilities.

**6. DEFERRED TAXES ON TAX-SUSPENSION EQUITY RESERVES**

For U.S. GAAP reporting purposes, the Group follows the provisions of SFAS 109, *Accounting for Income Taxes* ( **SFAS 109** ). In accordance with SFAS 109, the Group has recognized deferred tax assets and liabilities based on the difference between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect in the years when those temporary differences are expected to reverse. The effect on the deferred taxes of changes in tax rates is recognized in income in the period that includes the enactment date. Where it is more likely than not that all or a portion of a deferred tax asset will not be realized, a valuation allowance has been recorded against it in order to reduce the deferred tax asset to the amount that is more likely than not to be realized.

No provision has been made for Italian or foreign taxes that may result from future remittances of undistributed earnings of subsidiaries, as it is expected that all such earnings will be permanently reinvested in these operations. It is not practical to estimate the amount of taxes that might be payable on the eventual remittance of these earnings due to the complexities associated with its hypothetical calculation.

In connection with acquisitions in prior years, a portion of Net Operating Losses carry-forwards of the Group were covered by a valuation allowance at the date of acquisition. If these assets are subsequently recognized, the tax benefit will reduce goodwill and other non current intangible assets.

Under IFRS, IAS 12 *Income taxes*, allows, under certain conditions, for deferred income taxes on tax-suspension reserves not to be recorded, whereas, under U.S. GAAP, SFAS 109 provides that deferred taxes, in any case, shall be provided.

The valuation allowance amounted to 2,256 million as of December 31, 2006 and to 1,850 million as of December 31, 2005, with increases of 406 million and 391 million in 2006 and 2005, respectively. The valuation allowance is recorded because it is more likely than not that certain net operating losses will not be utilized.

## 7. OTHER

Other mainly comprises the following:

- **Impairment of Tangible and Intangible Assets**

Under U.S. GAAP, the Group follows the guidance provided in SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* to evaluate and account for impairments of depreciable assets or assets to be disposed of. Such statement provides that carrying values shall be firstly compared with undiscounted cash flows; as a result of this analysis in prior years certain impairment losses recorded under IFRS were deemed not necessary under U.S. GAAP and therefore had been reversed. In 2006, the undiscounted cash flows of certain assets were less than the carrying value under U.S. GAAP, resulting in the recognition of an additional impairment of 56 million.

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- **Provisions For Termination Benefit Incentives**

Under U.S. GAAP, in accordance with SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities* and SFAS 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, certain conditions must be met before a restructuring accrual can be established. Therefore, part of the accruals recorded for IFRS purposes ( 140 million) were reversed under U.S. GAAP in previous years and additional expense of approximately 70 million has been recognized under U.S. GAAP in 2006.

- **Derivatives Financial Instruments**

Under IFRS, the Group treats the call option in Sofora as a derivative instrument which is valued at fair value at the end of each reporting period as described in Note 8 Other Non-Current Assets. Under SFAS 133 *Accounting for Derivative Instruments and Hedging Activities*, the call option does not meet the definition of a derivative instrument and has been accounted for based at cost subject to review for impairment. The related income effect for the year 2006, resulting in a reduction of pre-tax income, amounts to 30 million.

- **Asset Retirement Obligations**

The Group capitalizes asset retirement costs and records a liability for the present value of the obligation at the inception of the retirement obligation under both IFRS and U.S. GAAP. Differently from U.S. GAAP, IFRS requires that adjustments are made to the asset retirement obligation and the related cost to reflect changes in discount rates. This results in differences in accretion expense of the retirement obligations and depreciation expense of the asset retirement costs between IFRS and U.S. GAAP.

- **Present Value Adjustments**

Under IFRS, liabilities are recorded at their present value. Under U.S. GAAP, liabilities with maturities exceeding one year are recorded at their present value only when required by a specific accounting standard.

**8. DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE**

Under U.S. GAAP, Telecom Italia identifies discontinued operations under the framework established by SFAS 144 which is similar to the framework of IFRS 5 *Non-Current Asset Held for Sale and Discontinued Operations* except as it relates to balance sheet presentation for comparative purposes. Under IFRS, only the comparative information for the statement of income and the cash flow statement is restated. Under U.S. GAAP, the comparative balance sheet shows the assets and liabilities of operations which were discontinued or sold on the current period separately. In 2006 and 2005, additional charges of 4 million and 180 million, respectively, were recorded under U.S. GAAP as a result of the reclassification to the statement of income of the amount of cumulative translation adjustments recorded prior to the date of adoption of IFRS. Under IFRS, the Group transferred the cumulative translation reserve to other equity reserves as permitted by IFRS 1 on the first adoption date.





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**NOTE 47 CONDENSED CONSOLIDATED U.S. GAAP FINANCIAL STATEMENTS**

The condensed consolidated balance sheets as of December 31, 2006 and 2005 and the condensed consolidated statements of income for the years ended December 31, 2006, 2005 and 2004 presented below have been prepared to reflect the principal differences between the Telecom Italia Group's accounting policies and U.S. GAAP discussed above.

**CONDENSED CONSOLIDATED BALANCE SHEETS****IN ACCORDANCE WITH U.S. GAAP AS OF DECEMBER 31, 2006 AND 2005**

|  | <b>As of December 31,</b> |                |
|--|---------------------------|----------------|
|  | <b>2006</b>               | <b>2005</b>    |
|  | <b>(millions of Euro)</b> |                |
| <b>ASSETS</b>  |                           |                |
| <b>NON-CURRENT ASSETS:</b>   |                           |                |
| Goodwill   | 50,207                    | 50,207         |
| Other intangible assets with an indefinite life  | 3,015                     | 3,020          |
| Intangible assets with a finite life   | 22,264                    | 23,971         |
| Tangible assets  | 18,188                    | 19,196         |
| Other non-current assets:  |                           |                |
| Deferred tax assets  | 187                       | 489            |
| Other  | 2,798                     | 3,299          |
| <b>TOTAL NON-CURRENT ASSETS</b>  | <b>96,659</b>             | <b>100,182</b> |
| <b>TOTAL CURRENT ASSETS, EXCLUDING DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE</b>        | <b>18,425</b>             | <b>22,698</b>  |
| <b>TOTAL DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE</b>                                  | <b>250</b>                | <b>424</b>     |
| <b>TOTAL ASSETS</b>  | <b>115,334</b>            | <b>123,304</b> |
| <b>EQUITY AND LIABILITIES</b>  |                           |                |
| <b>EQUITY</b>  |                           |                |
| <i>of which Share Capital</i>  | 43,823                    | 44,631         |
|  | 10,605                    | 10,599         |
| <b>MINORITY INTERESTS</b>  | <b>1,062</b>              | <b>1,346</b>   |
| <b>NON-CURRENT LIABILITIES:</b>  |                           |                |
| Non-current financial liabilities  | 41,712                    | 43,065         |
| Employee severance indemnities and other employee-related provisions                       | 1,261                     | 1,273          |
| Deferred tax liabilities   | 6,870                     | 7,796          |
| Provisions for risks and charges, miscellaneous payables and other non-current liabilities | 2,617                     | 2,804          |
| <b>TOTAL NON-CURRENT LIABILITIES</b>   | <b>52,460</b>             | <b>54,938</b>  |

|  |                |                |
|--|----------------|----------------|
| <b>CURRENT LIABILITIES:</b>  |                |                |
| Current financial liabilities  | 5,639          | 9,778          |
| Current income tax payables, trade and miscellaneous payables and other current liabilities                      | 12,350         | 12,326         |
| <b>TOTAL CURRENT LIABILITIES, EXCLUDING LIABILITIES RELATING TO DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE</b> | <b>17,989</b>  | <b>22,104</b>  |
| <b>TOTAL LIABILITIES RELATING TO DISCONTINUED OPERATIONS/ASSETS HELD FOR SALE</b>                                |                | <b>285</b>     |
| <b>TOTAL LIABILITIES(*)</b>  | <b>71,511</b>  | <b>78,673</b>  |
| <b>TOTAL EQUITY AND LIABILITIES</b>  | <b>115,334</b> | <b>123,304</b> |

(\*) Includes Minority Interests.

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**CONDENSED CONSOLIDATED STATEMENTS OF INCOME IN ACCORDANCE WITH U.S. GAAP FOR THE YEARS ENDED  
DECEMBER 31, 2006, 2005 AND 2004**

|   | Year ended December 31, |               |               |
|---|-------------------------|---------------|---------------|
|   | 2006                    | 2005          | 2004          |
|   | (millions of Euro)      |               |               |
| Revenues  | 31,275                  | 29,921        | 28,292        |
| Other income  | 606                     | 670           | 1,080         |
| <b>Total operating revenues and other income</b>  | <b>31,881</b>           | <b>30,591</b> | <b>29,372</b> |
| Total operating expenses  | (26,346)                | (24,717)      | (22,550)      |
| <b>Operating income</b>   | <b>5,535</b>            | <b>5,874</b>  | <b>6,822</b>  |
| Share of profits (losses) of associates and joint ventures accounted for using the equity method                                      | 48                      | (146)         | (5)           |
| Financial expenses, net   | (1,975)                 | (1,870)       | (1,456)       |
| <b>Income from continuing operations before taxes</b>   | <b>3,608</b>            | <b>3,858</b>  | <b>5,361</b>  |
| Income taxes  | (1,895)                 | (1,896)       | (2,462)       |
| <b>Net income before Minority Interests, discontinued operations/assets held for sale and cumulative effect of accounting changes</b> | <b>1,713</b>            | <b>1,962</b>  | <b>2,899</b>  |
| Minority Interests  | 36                      | (479)         | (1,167)       |
| Net income (loss) from discontinued operations/assets held for sale   | 113                     | 409           | (191)         |
| Cumulative effect of accounting changes, net of taxes   |                         | 47            |               |
| <b>Net income</b>   | <b>1,862</b>            | <b>1,939</b>  | <b>1,541</b>  |

|  | Year ended December 31, |      |        |
|--|-------------------------|------|--------|
|  | 2006                    | 2005 | 2004   |
|  | (Euro)                  |      |        |
| <b>Basic and Diluted Earnings Per Share (EPS) (*) (**)</b> |                         |      |        |
| Ordinary Share   | 0.09                    | 0.10 | 0.09   |
| Savings Share  | 0.10                    | 0.11 | 0.10   |
| <i>Of which:</i>   |                         |      |        |
| <i>From continuing operations</i>                          |                         |      |        |
| Ordinary Share   | 0.08                    | 0.08 | 0.10   |
| Savings Share  | 0.09                    | 0.09 | 0.11   |
| <i>From discontinued operations/assets held for sale</i>   |                         |      |        |
| Ordinary Share   | 0.01                    | 0.02 | (0.01) |
| Savings Share  | 0.01                    | 0.02 | (0.01) |

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

(\*\*) Change in accounting principle for Employee severance indemnities had no effect on Earnings Per Share.

The following table illustrates the detail of the total operating expenses line item in our Condensed Consolidated Statements of Income in accordance with U.S. GAAP for the Year Ended December 31, 2006 under the cost of sales method.

|  | Year ended         |
|--|--------------------|
|  | December 31, 2006  |
|  | (millions of Euro) |
| Cost of revenues (services and sales) (*)          | 11,157             |
| Selling, general and administrative expenses (*)   | 4,093              |
| Personnel costs                                    | 3,868              |
| Depreciation and amortization                      | 7,098              |
| (Gains) losses on disposals of non-current assets  | 46                 |
| Impairment (reversal) losses on non-current assets | 84                 |
| <b>Total operating expenses</b>                    | <b>26,346</b>      |

(\*) Exclusive of Personnel costs and Depreciation and amortization.

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- In December, 2004, the FASB issued Statement 123 (revised 2004) ( **SFAS 123(R)** ), *Share-Based Payment* . SFAS 123(R) replaces FASB Statement No. 123, *Accounting for Stock-Based Compensation* , which superseded APB Opinion No. 25, *Accounting for Stock Issued to Employees* . SFAS 123(R) requires all share-based awards to employees, including grants of employee stock options, be recognized in the financial statements based on their grant-date fair values. The related compensation costs are to be recognized over the period during which an employee is required to provide service in exchange for the award. We have adopted the prospective provisions of SFAS 123(R) to new and existing plans as of January 1, 2006. The grant-date fair values of unvested awards that are outstanding on the date of adoption are charged to expense over their remaining vesting periods. The introduction of SFAS 123(R) did not have an impact on the Group consolidated financial position or results of operations.

In March, 2005, the Securities and Exchange Commission ( **SEC** ) issued Staff Accounting Bulletin ( **SAB** ) No. 107, *Share Based Payment* . SAB 107 summarizes the views of the SEC staff regarding the interaction between SFAS 123(R) and certain SEC rules and regulations, and provides the staff's views regarding the valuation of share-based payment arrangements for public companies. We have adopted SAB 107 concurrently with the adoption of SFAS 123(R) with effect from January 1, 2006. The introduction of SAB 107 did not have an impact on the Group consolidated financial position or results of operations.

- In July 2005, the FASB issued FASB Staff Position (FSP) APB 18-1 ( **FSP APB 18-1** ), *Accounting by an Investor for its Proportionate Share of Other Comprehensive Income of an Investee Accounted for under the Equity Method in Accordance with APB Opinion No. 18 upon a Loss of Significant Influence* . The FSP requires that if an investor loses significant influence over an investee, the investor's proportionate share of the investee's equity adjustments for Other Comprehensive Income should be offset against the carrying value of the investment at the time significant influence is lost by the investor. The adoption of FSP APB 18-1 in 2006 did not have a material impact on the Group consolidated financial position or results of operations.
- In October 2005, the FASB issued FSP FAS 13-1, *Accounting for Rental Costs Incurred during a Construction Period* . The FSP concludes that rental costs associated with ground or building operating leases that are incurred during a construction period should be recognized as rental expense. The adoption of this FSP in 2006 did not have a material impact on the Group consolidated financial position or results of operations.
- In February 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments an amendment of FASB statements No. 133 and 140* ( **SFAS 155** ). SFAS 155 amends FASB Statement No. 133 *Accounting for Derivative Instruments and Hedging Activities* ( **SFAS 133** ) and No. 140 *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* . SFAS 155 among other things, allows any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation under SFAS 133, to be carried at fair value in its entirety, with changes in fair value recognized in earnings. In addition, SFAS 155 requires that beneficial interests in securitized financial assets be analyzed to determine whether they are freestanding derivatives or contain an embedded derivative. SFAS 155 is applicable to new or modified financial instruments in fiscal years beginning after September 15, 2006. The Group is currently evaluating the potential impact, if any, that the adoption of SFAS 155 will have on the consolidated financial position or results of operations.
- In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* ( **SFAS 156** ). SFAS 156 addresses the accounting for recognized servicing assets and servicing liabilities related to certain transfers of the

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servicer's financial assets and for acquisitions or assumptions of obligations to service financial assets that do not relate to the financial assets of the servicer and its related parties. SFAS 156 requires that all recognized servicing assets and servicing liabilities are initially measured at fair value, and subsequently measured at either fair value or by applying an amortization method for each class of recognized servicing assets and servicing liabilities. SFAS 156 is effective in fiscal years beginning after September 15, 2006. The Group is currently evaluating the potential impact, if any, that the adoption of SFAS 156 will have on the consolidated financial position or results of operations.

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- In June 2006, the FASB ratified the consensus on Emerging Issues Task Force ( **EITF** ) Issue No. 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement* ( **EITF 06-3** ). The scope of EITF 06-3 includes any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer and may include, but is not limited to, sales, use, value added, and certain excise taxes. EITF 06-3 states that presentation of taxes within the scope of this EITF on either a gross basis or a net basis is an accounting policy decision which should be disclosed pursuant to APB No. 22, *Disclosure of Accounting Policies*. If such taxes are significant, and are presented on a gross basis, the amounts of those taxes should be disclosed. The consensus on EITF 06-3 will be effective for interim and annual reporting periods beginning after December 15, 2006. The Group does not expect the adoption of EITF 06-3 to have a material impact on the consolidated financial position or result of operations.
- In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109*, ( **FIN 48** ). FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements uncertain tax positions that it has taken or expects to take on a tax return. The Group is currently evaluating the impact of adopting FIN 48 on the consolidated financial position and results of operations.
- In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, ( **SFAS 157** ). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The provisions of this standard apply to other accounting pronouncements that require or permit fair value measurements and do not require any new fair value measurement. The new Statement shall be adopted prospectively for fiscal years beginning after November 15, 2007. The Group is currently evaluating the potential impact, if any, that the adoption of SFAS 157 will have on the consolidated financial position or results of operations.
- In September 2006, the FASB ratified Emerging Issues Task Force Issue No. 06-1, *Accounting for Consideration Given by a Service Provider to Manufacturers or Resellers of Equipment Necessary for an End-Customer to Receive Service from the Service Provider* ( **EITF 06-1** ). This guidance requires the application of EITF 01-9, *Accounting for Consideration Given by a Vendor to a Customer* ( **EITF 01-9** ), when consideration is given to a reseller or manufacturer for benefit to the service provider's end customer. EITF 06-1 is effective for the first annual reporting period beginning after June 15, 2007. The Group does not expect the adoption of EITF 06-1 to have a material impact on its consolidated financial position or result of operations.
- In September 2006, the FASB issued Statement 158 ( **SFAS 158** ) *Employers Accounting for Defined Benefit Pension and Other Post retirement Plans an amendment of FASB Statements No. 87, 88, 106 and 132 (R)* that improves financial reporting by requiring an employer to recognize the overfunded or underfunded status of a defined benefit post-retirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. These requirements are effective as of the end of the fiscal year ending after December 15, 2006. This Statement had no effect in our financial position and results of operations. SFAS 158 also improves financial reporting by requiring an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions. This requirement is effective for fiscal years ending after December 15, 2008. The Group does not anticipate that the adoption of this requirement will have a significant effect in its results of operations, financial position or cash flows.
- In February 2007, the FASB issued Statement 159 ( **SFAS 159** ) *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* that permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This Statement is effective from fiscal years

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after November 15, 2007. The Company is currently determining the policy of adoption as well as the resulting effect of SFAS 159 on its results of operations and financial position.

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- Under IFRS, the *Provisions for employee severance indemnities*, to be accrued by Italian companies in accordance with the Italian Civil Code, is considered a defined benefit plan. The liability for this unfunded pension obligation is determined using the Projected Unit Credit Method .

Under U.S. GAAP, until December 31, 2004, the Group elected to account for it consistently with the Italian accounting policies as permitted by EITF 88-1 *Determination of Vested Benefit Obligation for a Defined Benefit Pension Plan* .

However, commencing in 2005 under U.S. GAAP, the Provisions for employee severance indemnities has been treated as a defined benefit plan, as required by IFRS. This is also a permitted option under the EITF 88-1, and as a consequence there was no reconciling adjustment in equity as of December 31, 2005 and 2006.

The effect of the cumulative catch up adjustment of 47 million in 2005 is separately disclosed in the condensed U.S. GAAP Statement of Income for the year ended December 31, 2005, in accordance with Accounting Principles Board Opinion 20 (APB 20) *Accounting Changes* . Had the change been applied in previous periods the net income for U.S. GAAP in 2004 would not have been significantly different.

- Effective January 1, 2006, the Group adopted the fair value recognition provisions of FASB Statement No. 123(R) ( **SFAS 123(R)** ), *Share-Based Payment*, using the modified prospective-transition method. For more detail please see (D) Stock-Based Compensation .

**(C) SECURITIZATION OF ACCOUNTS RECEIVABLE**

As discussed in Note 2 *Accounting Policies* , the Group entered into certain transactions for the on-going sale of trade accounts receivable to a Special Purpose Entity (TISV TI Securitization Vehicle S.r.l.) in a securitization program, which ended July 25, 2006.

In particular, Telecom Italia regularly sold a portfolio of trade receivables without recourse to the TI Securitization Vehicle S.r.l., which financed the purchase of the receivables by issuing asset-backed securities. The sales price of the receivables were paid to Telecom Italia partly as an Advanced Purchase Price (APP), at the time of sale, and partly as a Deferred Purchase Price (DPP).

Under the terms of the agreement, the Vehicle charged the Group an initial discount which varied based on the credit profile and other characteristics of each tranche of accounts receivable sold. Additionally, for the purposes of credit enhancement, the Vehicle withheld a portion of the purchase price as a deferred payment, representing the Group's retained interest in the sold receivables. The amount of deferred payment withheld was adjusted on a monthly basis based on an evaluation of actual collections, delinquencies and other factors. The Group retained the servicing responsibility related to the sold receivables and received a servicing fee from the Vehicle which was estimated to approximate the fair value of providing such services.

For invoices issued and sold through September 2005, with regard to the risk of uncollectability, Telecom Italia was responsible for the ultimate recovery from the debtors on the receivables sold, up to the limit of the amount of the DPP and the SPE retained the risk of uncollected amounts over the DPP. In accordance with SIC 12 (*Consolidation Special Purpose Entities* (SPE)), through September 30, 2005, TI Securitization Vehicle S.r.l. (TISV) was included in the scope of consolidation, because the exposure of the assignor to the risk of uncollectability of the deferred purchase price implied, in substance, control over the SPE.

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

Consequently, following the sale of the DPP without recourse, the risks and rewards of ownership of these receivables were transferred in full to the financial institutions which, having taken the control of the SPE, in accordance with SIC 12 provisions, consolidated TISV.

For U.S. GAAP, the accounting for the securitization of accounts receivable is primarily governed by SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* ( **SFAS 140** ).

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Under the provisions of SFAS 140, the sale agreement must meet certain defined criteria to qualify as a sale of financial assets, the Qualifying Special Purpose entity ( **QSPE** ) must meet certain defined criteria to preclude consolidation, and the amount of gain or loss on the sale is determined based on the consideration received, the carrying value of the underlying financial components sold and the fair value of the financial components retained. Even though the underlying accounting principles differ, there was no material difference on equity and net income as of and for the years ended December 31, 2006, 2005 and 2004 between IFRS and U.S. GAAP.

During 2006, 2005 and 2004 the following cash flows were received from and paid to the Vehicle:

|  | Year ended December 31, |            |            |
|--|-------------------------|------------|------------|
|  | 2006                    | 2005       | 2004       |
|  | (millions of Euro)      |            |            |
| Gross trade receivables sold to the Vehicle          | 3,595                   | 8,926      | 8,821      |
| Collections remitted to the Vehicle                  | (4,254)                 | (8,097)    | (8,012)    |
| Discount   | (18)                    | (92)       | (93)       |
| Remaining retained interest at year end              |                         | (181)      | (285)      |
| <b>Net cash received in advance from the Vehicle</b> |                         | <b>556</b> | <b>431</b> |

The amounts recorded in the consolidated condensed balance sheets and statements of income under U.S. GAAP for 2006, 2005 and 2004 are as follows:

|  | As of and for the year ended December 31, |      |      |
|--|---|------|------|
|  | 2006                                      | 2005 | 2004 |
|  | (millions of Euro)                        |      |      |
| <b>Balance Sheet Items</b>                 |   |      |      |
| Amounts due from the Vehicle               |   | 829  | 869  |
| Retained interest                          |   | 181  | 285  |
| Allowance for bad debts                    |   | 106  | 23   |
| <b>Statement of Income Items</b>           |   |      |      |
| Loss recognized in the statement of income | 18  | 116  | 116  |

The losses on the sales of receivables to the Vehicle are due to the discount applied by the Vehicle and, only for the years ended December 31, 2005 and 2004, the bad debt provisions made in order to adjust the retained risks to fair value as required by SFAS

140. The retained interests represented the deferred purchase price that was yet to be received from the Vehicle and were included under other current assets as of December 31, 2005 and 2004.

**(D) STOCK-BASED COMPENSATION**

At December 31, 2006, the Group has several stock-based employee compensation plans which are described more fully in Note 2 Accounting Policies and Note 42 Stock option plans of the Telecom Italia Group. Prior to January 1, 2006, the Group accounted for all of its employee compensation plans under the recognition and measurement provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and related Interpretations, as permitted by FASB Statement No. 123 ( **SFAS 123** ), *Accounting for Stock-Based Compensation*.

Effective January 1, 2006, the Group adopted the fair value recognition provisions of FASB Statement No. 123(R) ( **SFAS 123(R)** ), *Share-Based Payment*, using the modified prospective-transition method. There were no new stock options granted or modifications to outstanding options made during 2006. Compensation cost for the unvested options granted that were outstanding as of January 1, 2006 will be recognized over the remaining service period based on the compensation cost estimated for the SFAS 123 pro forma disclosures. Results for prior periods have not been restated. The effect of adopting SFAS 123(R) on operating income, income before taxes, net income, cash flows generated by operating activities, and basic and diluted earnings per share was immaterial.

The Group uses the Cox-Ross-Rubenstein ( **CRR** ) binomial model for estimating the fair value of employee stock options on the date of the grant which uses a binomial tree to assess the probabilities that the price of the underlying stock might follow over the life of the option.

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The following table illustrates the effect on net income if the Group had applied the fair value recognition provisions of SFAS 123 to options granted in all periods presented prior to the adoption of SFAS 123(R). For the purpose of this pro forma disclosure, the value of the options is estimated using the CRR option-pricing formula and charged to expense over the options' vesting periods.

|   | Year ended December 31, |              |
|---|-------------------------|--------------|
|   | 2005                    | 2004         |
|   | (millions of Euro)      |              |
| <b>Net income in accordance with U.S. GAAP</b>              | <b>1,939</b>            | <b>1,541</b> |
| Add: Stock-based compensation expense under APB 25          | 2                       | 3            |
| Less: Total stock-based compensation expense under SFAS 123 | (5)                     | (25)         |
| <b>Pro forma net income</b>                                 | <b>1,936</b>            | <b>1,519</b> |

The Group's pro forma earnings per share, had compensation costs been recorded in accordance with SFAS 123, would not be materially affected.

A summary of additional U.S. GAAP disclosures for the Telecom Italia Group stock option compensation plans is presented below:

|   | Number of<br>Options | Weighted Average<br>Exercise Price<br>(Euro) | Weighted Average<br>Contractual Life of<br>Options Outstanding<br>(years) | Aggregate<br>Intrinsic Value<br>(Euro) |
|---|----------------------|--|---|--|
| <b>Options outstanding at December 31, 2006</b> | <b>277,932,854</b>   | <b>2.99</b>                                  | <b>1.36</b>   |  |
| Options expected to vest at December 31, 2006   | 9,712,500            | 0.38   | 2.00  |  |
| <b>Options exercisable at December 31, 2006</b> | <b>268,220,354</b>   | <b>3.09</b>                                  | <b>1.34</b>   |  |

The weighted-average grant-date fair value of options granted during 2005 by Telecom Italia Media and in 2004 by Tim Hellas was approximately 0.12 and 2.69, respectively. The total intrinsic value of options exercised during the years ended December 31, 2006, 2005, and 2004, was approximately 0.4 million, 6 million, and 26 million, respectively.

The number of options expected to vest is based on estimated forfeitures of options that were outstanding at December 31, 2006. Once vested, options become exercisable immediately.

As of December 31, 2006, there was approximately 0.4 million of total unrecognized compensation cost related to non vested options granted under the plans. That cost is expected to be recognized over a weighted-average period of approximately 7 months.

Cash received from the options exercised under all plans for the years ended December 31, 2006, 2005 and 2004, was approximately 2 million, 60 million and 233 million, respectively.

**(E) DEFERRED TAX ASSETS AND LIABILITIES**

Paragraph 43 of SFAS 109, *Accounting for Income Taxes* requires the disclosure of the total of all deferred tax assets and the total valuation allowance, as well as the net change during the year in the valuation allowance.

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Below is the detail of gross deferred tax assets and liabilities as of December 31, 2006 and 2005, and the total valuation allowance under U.S. GAAP, as well as the net changes in the valuation allowance for each of the three years in the period ended December 31, 2006.

|                                 | <u>As of December 31,</u> |                |
|---------------------------------|---------------------------|----------------|
|                                 | <u>2006</u>               | <u>2005</u>    |
|                                 | (millions of Euro)        |                |
| Total deferred tax assets gross | 3,098                     | 4,365          |
| Total valuation allowance       | (2,256)                   | (1,850)        |
|                                 | <u>842</u>                | <u>2,515</u>   |
| Total deferred tax assets       |                           |                |
| Total deferred tax liabilities  | (7,453)                   | (7,810)        |
|                                 | <u>(6,611)</u>            | <u>(5,295)</u> |
| <b>Total net deferred taxes</b> |                           |                |

| <u>Changes in the valuation allowance</u>    | <u>Year ended December 31,</u> |              |              |
|--|--------------------------------|--------------|--------------|
|  | <u>2006</u>                    | <u>2005</u>  | <u>2004</u>  |
|  | (millions of Euro)             |              |              |
| <b>Valuation allowance beginning of year</b> | <b>1,850</b>                   | <b>1,459</b> | <b>2,223</b> |
| Provision (benefit)                          | 390                            | 324          | (842)        |
| Other additions (deductions)                 | 16                             | 67           | 78           |
|  | <u>2,256</u>                   | <u>1,850</u> | <u>1,459</u> |
| <b>Valuation allowance end of year</b>       |                                |              |              |

**(E) SUBSEQUENT EVENTS****Entel Bolivia**

The Bolivian government, in pursuing its policy of nationalizing various privately-owned businesses, including Entel Bolivia (acquired in 1995 by the Telecom Italia Group through the Dutch subsidiary ETI, entirely controlled by Telecom Italia International), recently issued a decree establishing a ministerial commission in order to start, conduct and conclude negotiations, within 30 days beginning from the publication of the decree, aimed at recovering Entel Bolivia for the State. The above-mentioned measure alleges that Entel Bolivia and ETI have committed a number of serious administrative and fiscal irregularities. Telecom Italia participated in the meetings with the commission with the sole aim of hearing the government's position with regard to the recovery of Entel Bolivia, but rejected all the allegations concerning the supposed irregularities. Subsequently, on April 23, 2007, the Bolivian government adopted two more measures cancelling all the previous laws which were the basis on which the previous government had acknowledged that Entel Bolivia had fulfilled all the obligations it had assumed when the company was privatized, declaring

that all initiatives taken in executing the abrogated laws (particularly the capital reduction of Entel Bolivia resolved at the end of 2005) would be punishable by law, and also annulled a number of further administrative measures, particularly the one passed in 1995, which had launched the Entel Bolivia privatization process.

On April 30, 2007, as a reaction to the position assumed by the commission and the measures adopted by the Bolivian government, and with the aim of protecting its interests in the country, ETI notified the government of its intention to start the procedure provided for in the bilateral treaty for the protection of investments between Bolivia and The Netherlands; upon such notification, the parties may initiate consultation procedures for six months with a view to settling amicably the conflict between them. This action is preliminary to the possibility of asking the International Center for Settlement of Investment Disputes (**ICSID**), an internal body of the World Bank, to start an international arbitration to resolve the dispute.

#### ***New Bonds Issues in Euro***

In May 2007, Telecom Italia S.p.A. priced two floating rate bonds in Euro issued for a total amount of 1,250 million.

The terms are as follows:

- **on May 29, 2007, 850 million:** issue date June 7, 2007, quarterly coupon equal to Euribor + 0.20%, issue price 99.915%, effective yield to maturity equal to Euribor 3 month + 0.23%, maturity date June 7, 2010;



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- **on May 31, 2007, 400 million:** issue date June 7, 2007, quarterly coupon equal to Euribor + 0.79%, issue price 100%, effective yield to maturity equal to Euribor 3 month + 0.79%, maturity date June 7, 2016.

The new bonds were issued pursuant to Telecom Italia's 15 billion Euro Medium Term Note (EMTN) Programme.

Application for the listing of the bonds shall be made with the Luxembourg Stock Exchange.

**Disputes, Litigation and Legal Proceedings Pending**

The information given in Note 26 Contingent Assets and Liabilities, Commitments and Other Guarantees on the main disputes involving the Telecom Italia Group is updated below.

- **FASTWEB**

With reference to the arbitration proceeding that Telecom Italia initiated in December 2005 with Fastweb S.p.A. concerning inverse termination, on May 19, 2007, the Arbitration Board notified Telecom Italia that the unilateral change made by Fastweb to its price for inverse termination was ruled to be illegal.

The Arbitration Board declared that it was competent to decide on the questions raised by Telecom Italia and Fastweb and falling outside the scope of the National Regulatory Authority, while leaving the latter to determine:

- (i) the price of the inverse termination service (the question is in fact the subject of a dispute between the parties pending before the National Regulatory Authority since December 2005, currently waiting for the Technical Consultant appointed by the Authority to begin its work again); and
- (ii) the time from which the change to the termination price was to apply (which, being related to the question of the determination of the price, will be established by the National Regulatory Authority in the context of the dispute filed earlier by Fastweb).

As regards the refunding of the higher-than-contractual amounts paid (subject to reserve) by Telecom Italia to Fastweb, the Arbitration Board suspended the proceeding until the decision of the National Regulatory Authority fixing the termination price, after which one or other of the parties may request it to be resumed within 6 months of such decision.

\* \* \*

With reference to the arbitration proceeding initiated by Fastweb in 2005 regarding alleged non-performance by Telecom Italia of the contract for the supply of local loop unbundling services, the Company has challenged the award before the Rome Court of Appeal.

- **VODAFONE**

As regards the petition relating to the Vodafone Casa Numero Fisso offer, the Lazio Administrative Court set a time limit for the National Regulatory Authority to produce the required information, pending which it suspended the enforceability of the administrative order. The hearing of the case is scheduled for June 2007.

- **WIND**

Following the petition submitted in November 2006 by the Associazione Italiana Internet Provider relating to Telecom Italia's Alice 20 Mega offer, on April 23, 2007 Wind also notified Telecom Italia of an appeal to the Lazio Regional Administrative Court for the suspension and subsequent annulment of the resolution adopted by the National Regulatory Authority that, by approving the Telecom Italia offer of single access ADSL wholesale flat with downstream velocities up to 20 Mbit/s using Ethernet/IP technology (marked by technical access parameters corresponding to those of the Alice 20 Mega retail service), authorized the continuation of Telecom Italia's Alice 20 Mega product on the grounds that the wholesale ADSL offers present on the market allowed the offer in question to satisfy the replicability requirement.

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According to Wind, the failure to disaggregate Telecom Italia's wholesale offer, the narrow profit margins granted to competing operators wishing to take it up and the impossibility of providing final clients with services equivalent to those proposed by Telecom Italia implied a loss of market shares for Wind and all of Telecom Italia's competitors.

Telecom Italia will take part in the proceedings as an adverse party.

- **ANTITRUST PROCEEDING A-357**

With reference to Antitrust Authority investigation to establish the violations of Articles 81 and 82 of the European Community Treaty, the time limit for completion of the investigation has been scheduled to terminate by August 10, 2007.

In the hearing of May 24, 2007 the Antitrust Authority ended its inquiry of Vodafone's activities without finding Vodafone liable of irregularities on the basis of the commitments undertaken pursuant to Article 14 ter. of Law No. 287/90 by Vodafone on November 10, 2006.

The final hearing took place on June 6, 2007.

- **BRAZIL**

In relation to the various disputes in which Telecom Italia Group is involved, it should be noted that: following the termination of the agreement regarding the merger of Brasil Telecom Celular into Tim Brasil, Telecom Italia International, Tim International and Tim Brasil applied for the closure of the related court proceedings since the matter at issue no longer existed. In one case the judge upheld the request, whereas in the second case the proceedings are still pending.

In 2006 Brasil Telecom and Brasil Telecom Celular had initiated arbitration proceedings against Tim International and Tim Brasil before the International Chamber of Commerce ( **ICC** ) in Paris challenging the validity of the agreement (and asking damages) regarding the merger of Brasil Telecom Celular into Tim Brasil. Following a request by Brasil Telecom, the Arbitration Panel suspended the proceedings in April 2007 pending the decision in other arbitration proceedings under way between Telecom Italia International, Telecom Italia, Techold and Timepart.

The four arbitration proceedings between Telecom Italia International and Techold (and in one case Timepart) (in one of which, following a request of Techold, Telecom Italia S.p.A. is involved) are at trial stage and the hearings have been held before the ICC in Paris.

- **CUBA**

As regards the dispute between ETECSA and Banco Nacional de Comercio Exterior ( **Bancomext** ) it should be noted that in November 2006 the Paris Court of Appeal upheld ETECSA s request to declare the arbitration award of August 5, 2004 null and that ETECSA accordingly applied to the Turin Court of Appeal for the revocation of the provisional enforceability of the judgment of the Court of Turin. The application has been denied on procedural grounds.

- **GREECE**

The proceedings are still at the preliminary stage.

- **CONSIP TENDER**

In a ruling dated May 31, 2007 the Lazio Administrative Court rejected Telecom Italia s appeal.

- **ACTIONS BROUGHT AGAINST OTHER OPERATORS FOR UNFAIR COMPETITION AND VIOLATION OF PRIVACY**

We are awaiting the issuance of the ruling by the Court.

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**EXHIBITS**