

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

WASHINGTON, D.C. 20549

FORM 20-F/A

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

OR

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

For the fiscal year ended: December 31, 2003

OR

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

For the transition period from N/A to N/A

Commission file number: 1-13882

Telecom Italia S.p.A.

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(Exact name of Registrant as specified in its charter)

Italy

(Jurisdiction of incorporation or organization)

Piazza degli Affari 2, 20123 Milan, Italy

(Address of principal executive offices)

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

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

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

None

(Title of Class)

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

None

(Title of Class)

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

Not applicable

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No Not Applicable

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

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

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INTRODUCTION

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

Unless otherwise indicated, the financial information contained in this Annual Report has been prepared in conformity with the Italian law governing consolidated financial statements interpreted and integrated by the accounting principles established or adopted by the Italian Accounting Profession (Italian GAAP), which, as described in Note 27 of Notes to the Consolidated Financial Statements, differ in certain material respects from generally accepted accounting principles in the United States (U.S. GAAP). Unless otherwise indicated, any reference in this Annual Report to Consolidated Financial Statements is to the Consolidated Financial Statements of the Telecom Italia Group (including the notes thereto) included herein.

Cautionary Statement for Purposes of the Safe Harbor Provisions of the United States Private Securities Litigation Reform Act of 1995.

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. This Annual Report contains certain forward-looking statements, including, but not limited to, the discussion of the changing dynamics of the marketplace, including the continuing developments in competition in all aspects of our businesses from new competitors and from new and enhanced technologies, our outlook for growth in the telecommunications industry both within and outside of Italy, including our targets under our 2004-2006 business plan and our outlook regarding developments in the telecommunications industry, including certain trends we have identified particularly in our core Italian market, continuing regulatory measures regarding pricing and access for other local operators. Such statements include, but are not limited to, statements under the following headings: (i) Item 3. Key Information Risk Factors, (ii) Item 4. Information on the Telecom Italia Group Business Significant Developments during 2003 Updated Business Plan and Strategy, (iii) Item 4. Information on the Telecom Italia Group Regulation, (iv) Item 5. Operating and Financial Review and Prospects, (v) Item 8. Financial Information Legal Proceedings and (vi) Item 11. Quantitative and Qualitative Disclosures About Market Risk, including statements regarding the likely effect of matters discussed therein. Actual results may differ materially from those projected or implied in the forward-looking statements. Such forward-looking information involves risks and uncertainties, which are outside our control, that could significantly affect expected results and are based on certain key assumptions.

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

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

- the success of our customer loyalty and retention programs, particularly in the fixed line business, and the impact of such programs on our revenues;
- the impact of regulatory decisions and changes in the regulatory environment, including implementation of recently-adopted EU directives in Italy;
- the impact and consequences of the Merger;
- the impact of the slowdown in Latin American economies and the slow recovery of economies generally on our international business focused on Latin America and on our foreign investments and capital expenditures;
- the continuing impact of rapid or disruptive changes in technologies;

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- the impact of political and economic developments in Italy and other countries in which we operate;
- the impact of fluctuations in currency exchange and interest rates;
- our ability to successfully implement our 2004-2006 Industrial Plan;
- our ability to successfully achieve our debt reduction targets;
- our ability to successfully roll out our UMTS networks and services and to realize the benefits of our investment in UMTS licenses and related capital expenditures;
- our ability to successfully implement our internet and broadband strategy both in Italy and abroad;
- our ability to achieve the expected return on the significant investments and capital expenditures we have made and continue to make in Latin America;
- the amount and timing of any future impairment charges for our licenses, goodwill or other assets; and
- the impact of litigation or decreased mobile communications usage arising from actual or perceived health risks or other problems relating to mobile handsets or transmission masts.

The foregoing factors should not be construed as exhaustive. Due to such uncertainties and risks, readers are cautioned not to place undue reliance on such forward-looking statements, which speak only as of the date hereof. We undertake no obligation to release publicly the result of any revisions to these forward-looking statements which may be made to reflect events or circumstances after the date hereof, including, without limitation, changes in our business or acquisition strategy or planned capital expenditures, or to reflect the occurrence of unanticipated events. See Item 3. Key Information Risk Factors and the related cautionary statement under Item 5. Operating and Financial Review and Prospects .

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KEY DEFINITIONS

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

Telecom Italia	means the entity which resulted from the Merger.
Telecom Italia Group	means the Company and its consolidated subsidiaries.
Old Telecom Italia and Old Telecom Italia Group	means Telecom Italia and its consolidated subsidiaries as they existed immediately prior to the effective date of the Merger.
Olivetti	means Olivetti S.p.A., the holding company and controlling shareholder of Old Telecom Italia.
Olivetti Group	means Olivetti and its consolidated subsidiaries, including Old Telecom Italia.
Merger	means the merger of Old Telecom Italia into Olivetti, approved by the shareholders of Old Telecom Italia and Olivetti on May 24, 2003 and on May 26, 2003, respectively, which became effective on August 4, 2003.
Shares	means the ordinary shares, 0.55 par value each, of Telecom Italia.
Savings Shares	means the savings shares, 0.55 par value each, of Telecom Italia.
TIM	means Telecom Italia Mobile S.p.A., the Telecom Italia Group's subsidiary operating in the mobile telecommunications business.
Telecom Italia Media	means the corporate name of the remaining part of Seat Pagine Gialle S.p.A., which resulted after the proportional spin-off of the directories and almost all of the directory assistance and business information business segments of SEAT into New SEAT. The spin-off became effective on August 1, 2003 and new SEAT was disposed of on August 8, 2003. Telecom Italia Media is the Telecom Italia Group's subsidiary operating the Internet & Media business.
EU	means the European Union.

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PART I

Item 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS

Not Applicable

Item 2. OFFER STATISTICS AND EXPECTED TIMETABLE

Not Applicable

Item 3. KEY INFORMATION

RISK FACTORS

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

Strong domestic competition exists in all of the principal telecommunications business areas in Italy in which we operate, including, most significantly, our fixed-line and mobile voice telecommunications businesses. This competition may increase further due to the consolidation and globalization of the telecommunications industry in Europe and elsewhere. Consolidation is increasing rapidly and competition is expected to rise at all levels in the future. In addition, the use of the single European currency and the liberalization of the Italian telecommunication market has further intensified competition by facilitating international operators' entry into the Italian market and direct competition with our fixed line and mobile telephony businesses, particularly in the local and long-distance markets. As of December 31, 2003, there were a number of significant competitors offering fixed-line services and three other operators offering mobile services in the Italian domestic market; the third mobile competitor (H3G) entered the market in 2003, offering third generation commercial services. Although we stopped the decline in our market share of voice traffic in our fixed line business during 2003, continuing pressures on prices due to competition and further erosion in market shares could adversely affect our results of operations. Additional changes in the regulatory regime, including carrier preselection, number portability and local loop unbundling as well as the implementation of new EU telecommunications directives could further increase competition for the services we provide, particularly in our fixed line business, which could also adversely affect our business.

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

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

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revenue sources, in addition to carrying voice traffic on our networks. These services include non-voice services such as ADSL, which provides services such as fast Internet, multimedia and video conferencing, data traffic and value-added services such as interactive mobile services that allow users to receive news or engage in simple banking transactions. Other revenue sources also include increased interconnection traffic from other operators using our fixed-line network. In addition to the introduction of new services in recent years, we continue to develop new products and services, such as new data services for business customers, broadband services, enhanced communication services and new equipment and voice packages, in order to attract and retain customers, particularly business customers, and to stimulate usage of our fixed and wireless telecommunications network. We are also investing in new infrastructure and technologies to enable us to introduce new products and services. We expect that these strategic initiatives will require substantial expenditures and commitment of human resources. Although these initiatives are core to our strategy, we may be unable to introduce commercially these new products and services, and even if we introduce them, there can be no assurance they will be successful.

Our business will be adversely affected if we are unable to successfully implement our business plans, particularly in light of the Merger. Factors beyond our control may prevent us from successfully implementing our strategy.

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

- Strengthen competitive capabilities;

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

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

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

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

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

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

Our fixed and mobile telecommunications operations, as well as our broadband services businesses, are subject to significant extensive regulatory requirements in Italy and our international operations and investments are subject to regulation in their host countries. In Italy, we are the only operator subject to universal service obligations, which requires us to provide:

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

In addition, the Italian regulator responsible in Italy for the regulation of the telecommunications, radio and television broadcasting sector (the National Regulatory Authority) has identified the Company as an operator having significant market power in all relevant markets. As a result, we are, or will be, subject to a number of regulatory constraints, including:

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

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As a member of the EU, Italy is required to adapt its telecommunications regulatory framework to the legislative and regulatory framework established by the EU for the regulation of the European telecommunications market. The EU Commission approved a new electronic communications framework in March 2002 which has been effective in Italy since September 2003. The implementation of these revised telecommunications regulations and possible future decisions relating thereto may change the regulatory environment in a manner adverse to us. Please see Item 4. Information on the Telecom Italia Group Regulation in this report for more information on the regulatory requirements to which we are subject.

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

We may not achieve the expected return on our significant investments and capital expenditures made in Latin America due to the competitive environment in these markets.

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

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

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

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

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

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

Our business is dependent on general economic conditions in Italy, including levels of interest rates, inflation and taxes. A significant deterioration in these conditions could adversely affect our business and results of operations. We may also be adversely affected by political and economic developments in other countries

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where we have made significant investments in telecommunications operators. Some of these countries have political, economic and legal systems that are unpredictable. Political or economic upheaval or changes in laws or their application in these countries may harm the operations of the companies in which we have invested and impair the value of these investments. We have had investments in Turkey, Argentina and Brazil in recent years in which we have had to take significant write-downs in value due to political and economic developments in those countries. A significant additional risk of operating in emerging market countries is that foreign exchange restrictions could be established. This could effectively prevent us from receiving profits from, or from selling our investments in, these countries.

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

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

Our total gross financial debt at year end 2003 was 41,465 million (40,631 million at year end 2002) and included borrowings of 5,274 million relating to the cash out for the Merger. Although our total interest payable has decreased as the result of average debt exposure reduction and of interest rate fluctuations our exposure of total debt subject to floating interest rates increased as a result of the Merger. We enter into derivative transactions to hedge our interest exposure and to diversify debt parameters in order to reduce debt cost and volatility within predefined target boundaries. However, we can give no assurance that fluctuations in interest rates will not adversely affect our results of operations.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Any of the above factors may adversely affect our business and results of operations.

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

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

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

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

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

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

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

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

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

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

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

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

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Risks associated with Telecom Italia's ownership chain

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

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

Although Olimpia does not own a controlling interest in Telecom Italia voting shares, Olimpia retains significant power as a result of its proposal of a majority of the present Telecom Italia Board members who were elected in May 2004. As a result, Olimpia, may be able to influence certain corporate actions and may exert a significant influence on all matters to be decided by a vote of shareholders. In principle, the interests of Olimpia in deciding these matters could be different from the interests of Telecom Italia's other ordinary shareholders and it is possible that certain decisions could be taken that may be influenced by the needs of Olimpia.

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

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

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

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

For convenience only (except where noted otherwise), certain euro figures have been translated into dollars at the rate (the **Euro/Dollar Exchange Rate**) of 1.00 = U.S.\$1.2210, using the noon buying rate in The City of New York for cable transfers in foreign currencies as announced by the Federal Reserve Bank of New York for customs purposes (the **Noon Buying Rate**) on June 1, 2004. These translations should not be construed as a representation that the euro amounts actually represent such dollar amounts or have been or could be converted into dollars at the rate indicated.

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

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

The following table sets forth for the years 1999 to 2003 and for the beginning of 2004 certain information regarding the Noon Buying Rate for Dollars expressed in U.S.\$ per 1.00.

Calendar Period	High	Low	Average(1)	At Period End
1999	1.1812	1.0016	1.0588	1.0070
2000	1.0335	0.8270	0.9207	0.9388
2001	0.9535	0.8425	0.8909	0.8901
2002	1.0485	0.8594	0.9495	1.0485
2003	1.2597	1.0361	1.1411	1.2597
2004 (through June 1, 2004)	1.2853	1.1801	1.2265	1.2210
Monthly Amounts				
December 2003	1.2597	1.1956	1.2284	1.2597
January 2004	1.2853	1.2389	1.2638	1.2452
February 2004	1.2848	1.2426	1.2640	1.2441
March 2004	1.2431	1.2088	1.2261	1.2292
April 2004	1.2358	1.1802	1.1989	1.1975
May 2004	1.2274	1.1801	1.1989	1.1975
June 2004 (through June 1, 2004)	1.2210	1.2210	1.2210	1.2210

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

The shares and savings shares of Old Telecom Italia and the shares of Olivetti have traded on *Mercato Telematico Azionario* (**Telematico**), managed by Borsa Italiana S.p.A. (**Borsa Italiana**) in euro since January 4, 1999. Fluctuations in the exchange rate between the euro and the U.S.

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dollar will affect the U.S. dollar equivalent of the euro price of the Shares and the Savings Shares and the price of the American Depositary Shares (ADSs) and the Savings Share American Depositary Shares (Savings Share ADSs), on the New York Stock Exchange (NYSE). Cash dividends were paid by Old Telecom Italia and Olivetti in lire until 2001 (Olivetti paid no dividend in 2001) and in euro starting from 2002 (Olivetti paid no dividend in 2002). Exchange rate fluctuations will affect the U.S. dollar amounts received by owners of ADSs and Savings Share ADSs upon conversion by the Depositary of cash dividends paid in euro on the underlying Shares and Savings Shares. See Item 10. Additional Information Description of American Depositary Receipts .

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

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SELECTED FINANCIAL AND STATISTICAL INFORMATION

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

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

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

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

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

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

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

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

Amounts in accordance with U.S. GAAP:

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

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

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

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

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

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

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

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

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

The calculations take into account the requirement that holders of Savings Shares are entitled to an additional dividend equal to 2% of the par value of shares above dividends paid on the Shares; until July 2000 the par value of ordinary, savings and preferred shares was Lire 1,000 per share. Furthermore, the Extraordinary Shareholders' Meeting of Telecom Italia (formerly Olivetti S.p.A.) held on July 4, 2000 approved the

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

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

- (5) Telecom Italia's dividend coupons for the year ended December 31, 2003, were clipped on May 24, 2004, and such dividends for the year ended December 31, 2003 were payable from May 27, 2004.
- (6) In accordance with U.S. GAAP, the Net income (loss) per Share has been calculated using the two class method, since the Company has both Shares and Savings Shares outstanding. Under this method, set forth in Statement of Financial Accounting Standards No. 128, Earnings per Share, Basic earnings per share is computed by dividing income available to shareholders by the weighted average number of shares outstanding, and diluted earnings per share is increased to include any potential common shares and is adjusted for any changes to income that would result from the assumed conversion of those potential common shares. For the purpose of these calculations, the weighted average number of Shares was 3,424,694,178 for the year ended December 31, 2001 and 4,054,375,543 for the year ended December 31, 2002 and the weighted average number of Shares and Savings Shares was 6,620,513,494 and 2,414,967,112 for the year ended December 31, 2003. The calculations take into account the requirement that holders of Savings Shares are entitled to an additional dividend equal to 2% of the par value of Savings Shares above dividends paid on the Shares. The calculations take also into account that 2001 and 2002 (after the redenomination of the share capital into Euro following the resolution taken by the Extraordinary Shareholders Meeting held on July 4, 2000) the par value of Shares was 1 per share, and that in 2003, after the Merger, the par value of Shares and Savings Shares was reduced to 0.55 per share. In addition, in accordance with U.S. GAAP, net income (loss) per Savings Share Basic was 0.21 in 2003.
- (7) Stockholders' equity under U.S. GAAP is calculated after elimination of minority interest. See Note 27 of Notes to Consolidated Financial Statements included elsewhere herein.
- (8) Gross Operating Profit was 12,131 million, 13,117 million, 12,216 million, 13,655 million, 14,015 million and 14,280 million in each of 1999, 2000 (historical), 2000 (pro forma), 2001, 2002 and 2003, respectively. Gross Operating Profit was 3,308 million and 3,494 million in the three months ended March 31, 2003 and 2004, respectively. Because Gross Operating Profit includes certain financial statement items and excludes others it is considered a non-GAAP financial measure as defined in Item 10 of Regulation S-K under the 1934 Act. Telecom Italia believes that Gross Operating Profit provides a useful measure of the Telecom Italia Group's operating performance. Gross Operating Profit provides shareholders with an additional level of detail, after operating revenues and before operating income, showing what we believe is an accurate indicator of the Telecom Italia Group's and individual segments' operating results before certain cash and non-cash charges and income arising primarily from ancillary activities. In addition the Telecom Italia Group also believes (although other telecommunications operators will calculate such information differently) that Gross Operating Profit permits an adequate comparison of the Telecom Italia Group's performance against its peer group. Telecom Italia uses Gross Operating Profit, among other measures, as a target for operating performance both internally in our business plan and externally to investors and analysts. As such, Gross Operating Profit is monitored periodically by Telecom Italia management in order to measure Telecom Italia's performance relative to our target. As calculated, Gross Operating Profit is intended to provide shareholders with an operating measure which reflects our consolidated operating revenues less our consolidated operating expenses most directly related to the operations of our business, such as personnel costs. As noted above, Gross Operating Profit eliminates certain cash and non-cash charges which are part of operating our businesses but reflect estimates based on our judgement in applying accounting principles, such as bad debt reserves to cover customers who do not pay their bills, rather than expenses directly related to the operations of our businesses. In addition, Telecom Italia management monitors Gross Operating Profit or similar measures as reported by other telecommunications operators in Italy and abroad, and by other major listed companies in Italy, in order to measure our performance relative to such companies. In certain instances, Gross Operating Profit is also used as a benchmark for purposes of assessing the variable component (i.e., annual bonuses) of our employees' compensation, including in negotiations with our employees' labor unions. Gross Operating Profit is reported in our Italian annual report to shareholders and is used in presentations to investors and analysts. The following table reconciles operating income to the calculation of Gross Operating Profit by showing the Statement of Operation items included in calculating Gross Operating Profit.

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

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

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- (9) Net Financial Debt is a non-GAAP financial measure as defined in Item 10 of Regulation S-K under the 1934 Act. Although Net Financial Debt is a non-GAAP measure, it is widely used in Italy by financial institutions to assess liquidity and the adequacy of a company's financial structure. Telecom Italia believes Net Financial Debt provides an accurate indicator of Telecom Italia's ability to meet its financial obligations, represented by gross debt, from its available liquidity, represented by the other items shown in the reconciliation table. Net Financial Debt allows Telecom Italia to show investors the trend in our net financial condition over the periods presented. The limitation on the use of Net Financial Debt is that it effectively assumes that gross debt can be reduced by our cash and other liquid assets. In fact, it is unlikely that we would use all of our liquid assets to reduce our gross debt all at once, as such assets must also be available to pay employees, suppliers and taxes, and to meet other operating needs and capital expenditure requirements. Net Financial Debt and its ratio to total shareholders' equity (including minority interests), or leverage, are used to evaluate our financial structure in terms of sufficiency and cost of capital, level of debt, debt rating and funding cost, and whether our financial structure is adequate to achieve our business plan and our financial targets (which include our debt ratio, or net debt divided by net invested capital, the latter meaning net assets excluding Net Financial Debt). Telecom Italia management believes that Telecom Italia's financial structure is sufficient to achieve our business plan and financial targets. Telecom Italia management monitors the Net Financial Debt and leverage or similar measures as reported by other telecommunications operators in Italy and abroad, and by other major listed companies in Italy, in order to assess our liquidity and financial structure relative to such companies. We also monitor the trends in our Net Financial Debt and leverage in order to optimize the use of internally-generated funds versus funds from third parties. Net Financial Debt is reported in our Italian annual report to shareholders and is used in presentations to investors and analysts. Net Financial Debt is calculated as follows:

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

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

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

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

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

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

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

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

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

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

Dividends

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

Dividends declared by Old Telecom Italia. The following table sets forth the dividends per share and per savings share declared by Old Telecom Italia with respect to the last four fiscal years ended December 31, 1999, 2000, 2001 and 2002, respectively, and the aggregate dividend paid in such years. Actual dividends paid are rounded to the nearest whole cent.

Year ended December 31,	Dividends on Shares			Dividends on Savings Shares		
	Euros per Share	U.S. dollars per Share(2)	(millions of euros)	Euros per Share	U.S. dollars per Share(2)	(millions of euros)
1999(1)	0.3099(3)	0.29	1,638.10	0.3218(3)	0.30	688.58
2000(1)	0.3125	0.27	1,643.93	0.3238	0.28	664.84
2001	0.3125(4)	0.28	1,644.19	0.3237(4)	0.29	662.33
2002	0.1357(5)	0.13	713.47	0.1357(5)	0.13	273.11

- Dividends for 1999 and 2000 were paid in lire. The lire amounts were translated into euros at the irrevocably-fixed rate of exchange of Lit. 1,936.27 = 1.
- Euro amounts have been translated into U.S. dollars using the Noon Buying Rate in effect on the respective payment dates.
- The per share amount paid with respect to the fiscal year ended December 31, 1999 includes the distribution to all shareholders of Old Telecom Italia of the dividends payable on 26,046,820 savings shares held in treasury on the date the dividend was paid. A total of approximately 3.12 million was also distributed from the statutory reserve in order to round up such per share amounts.
- Approved at the Annual Meeting of Shareholders of Old Telecom Italia held on May 7, 2002. Old Telecom Italia's dividend coupons for the year ended December 31, 2001 were clipped on May 20, 2002 and were payable from May 23, 2002. Dividends for the year ended December 31, 2001 were paid also utilizing reserves.

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

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

Year ended December 31,	Dividends on Shares			Dividends on Savings Shares			Dividends on Preferred Shares		
	Euros per Share	U.S. dollars per Share(2)	(millions of euros)	Euros per Share	U.S. dollars per Share(2)	(millions of euros)	Euros per Share	U.S. dollars per Share(2)	(millions of euros)
1999(1)	0.0310	0.0289	148.92	0.1937	0.1807	15.23	0.0362	0.0338	0.55
2000(1)(3)	0.0350	0.0299	254.87						
2001	0	0	0						
2002	0	0	0						
2003(4)	0.1041	0.1278	1,072.95	0.1151	0.1413	667.11			

- (1) Dividends for 1999 and 2000 were paid in lire. The lire amounts were translated into euros at the irrevocably-fixed rate of exchange of Lit.1,936.27 = 1.
- (2) Euro amounts have been translated into U.S. dollars using the Noon Buying Rate in effect on the respective payment dates.
- (3) On July 24, 2000, the compulsory conversion of the Olivetti savings and preferred shares into Olivetti ordinary shares (approved by the Extraordinary Shareholders Meeting held on July 6, 2000) became effective.
- (4) Approved at the Annual Shareholders Meeting held on May 6, 2004. Pursuant to Italian Stock Exchange rules, dividends on the Shares and the Savings Shares are payable from the fourth business day after the third Friday of each month, and in any case, at least four business days after the Annual Meeting of Shareholders approving the dividends. Telecom Italia's dividend coupons for the year ended December 31, 2003 were clipped on May 24, 2004, and were payable from May 27, 2004.

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

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

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

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

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

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

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

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Item 4. INFORMATION ON THE TELECOM ITALIA GROUP

BUSINESS

Background

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

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

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

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

On August 4, 2003, Old Telecom Italia merged with and into Olivetti (the Merger) with Olivetti as the surviving company changing its name to Telecom Italia S.p.A. Please see Merger with Olivetti. Following the Merger, the proportionate ownership of Telecom Italia's share capital by shareholders unaffiliated with Pirelli S.p.A. (Pirelli), Olimpia's largest shareholder or Olimpia, increased substantially to approximately 88.43% of the outstanding Ordinary Shares. Since that date Olimpia has acquired additional shares through market purchases and Olimpia is currently the largest shareholder of Telecom Italia with approximately a 17% holding of Telecom Italia's Shares.

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

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

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

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

Before the Merger

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

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

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

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

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On completion of the Merger

Note 2: Shareholders of Pirelli & C. S.p.A. with a 5% stake or greater in the voting capital of the company include: Camfin CAM Finanziaria S.p.A. (23.732%).

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

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

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

General

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

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

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

Significant Developments during 2003

Merger with Olivetti

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

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

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

In connection with the Merger, the following transactions occurred:

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

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

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

SEAT Spin-off and Sale

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

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

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

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

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

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

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

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

Sale of Telecom Italia's stake in New SEAT

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

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

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

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Notes Issue

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

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

Such notes included:

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

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

Disposition and Acquisition of Significant Equity Investments in 2003

Dispositions

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

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

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

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

Acquisitions

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

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

Recent Developments during 2004

Sale of shares in Telekom Austria

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

Sale of shares in Euskaltel

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

TIM's stake in Digitel

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

Decrease in share capital of Solpart Participações (Solpart)

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

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

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

Agreement for the sale of GPP

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

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

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

Overview of the Telecom Italia Group's Major Business Areas

The following is a chart of the Telecom Italia Group's business units as of December 31, 2003:

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

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

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

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

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

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

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

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

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Updated Business Plan and Strategy

Updated Business Plan

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

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

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

Wireline

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

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

In particular, we intend to:

- maintain our domestic leadership in our core business (voice services, internet access, data transmission services for businesses, national and international wholesale services);
- consolidate our operational capabilities with the objective of offering best in class service levels to our customers and leverage opportunities to retain our client base by enhancing customer loyalty (through billing, customer relations management (CRM) and customer contact);
- concentrate on developing value added services, both for corporate and residential customers, to sustain revenue and margin levels, building, in particular, on the increasing penetration of internet and broadband contents and services (including WiFi), but also on innovation in voice and videocommunication services and terminals, equipped with new facilities, similar to mobile phone functions;

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- run efficient operations and continue our cost-cutting program (personnel, real estate, general and administrative, network);
- maintain competitive services and focus investment on enhancing network evolution and innovation such as optical transport and IP (Internet Protocol) services; and
- expand the wireline broadband offer in selected areas throughout Europe (such as Germany and France) with the creation of facility-based operators providing broadband access and value-added services by capitalizing on domestic expertise.

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

Mobile

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

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

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

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

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

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

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

Internet and Media

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

International Activities

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

Table of Contents**Capital Expenditures**

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

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

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

	Approximate % of Industrial Investments
Wireline	42%
Mobile	47%
Internet and Media	1%
Other	10%

Financial Targets

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

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

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

2004-2006

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

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

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

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The Organizational Structure

Telecom Italia Group's organizational structure includes:

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

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

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

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

Reorganization

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

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

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

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

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

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

The Wireline Business Unit operates on a national level as the consolidated market leader in wireline telephone and data services and call centers, for final retail customers and wholesale providers. On an international level, Wireline develops fiber optic networks for wholesale customers, mainly in Europe and South America. Aggressive competition in the Italian domestic market continued during 2003. Competition was particularly significant for national traffic and Wireline countered with new rate plans offered as part of the action to win back and retain customers.

The Wireline Business Unit accounted for gross operating revenues of 17,216 million in 2003, 17,047 million in 2002 and 17,174 million in 2001. The 2003 results of operations reversed last years trend with positive growth of about 1% in gross operating revenues which is one of the most important goals of the Wireline Business Unit s strategy.

The organizational structure of the Wireline Business Unit as of December 31, 2003 was as follows:

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

Key Issues in Italy

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

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

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

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

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

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

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

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

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

(3) Excluding internal lines.

(4) Number of contracts.

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

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

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

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

Wireline Strategic Business Areas

Retail Telephone

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

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

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

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Retail Internet

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

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

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

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

Data Business

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

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

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

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

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

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

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

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

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

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

Table of Contents**Retail Value Added Services**

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

Wholesale

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

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

Traffic and Tariffs**Domestic Traffic**

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

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

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

Domestic Fees and Tariffs. Since November 1, 1999, the Telecom Italia Group's traffic tariffs have been based on a per second billing system with an initial fixed charge (the call set up). The tariff per call set up (VAT included) varies depending on the kind of call: 0.0619 for local calls, 0.0787 for long distance calls and for fixed-mobile calls of business customers, 0.1200 for fixed-mobile calls of residential customers and 0.3098 for international calls. The tariff per second varies according to the kind of call, the time of day and the day of the week. Since December 1997, the Telecom Italia Group has introduced tariff packages for residential and business customers which provide for discounts on national and international traffic tariffs and additional rental charges.

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

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

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

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

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

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

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

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

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

- access;
- local and long distance calls; and
- fixed to mobile traffic, limited to the fixed call segment which is retained by Telecom Italia (the Retention segment).

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

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The National Regulatory Authority fixed the value of X as follows:

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

Such new price caps cover:

- basic subscriber charges and other access charges: $RPI + 0\%$, as well as a sub-price cap for residential subscription charges of $RPI - RPI$ ($RPI-RPI=0$);
- local and long distance calls with a cap equal to $RPI-RPI$; and
- fixed to mobile traffic, limited to the fixed call segment belonging to Telecom Italia (the Retention segment) with a cap equal to $RPI-6\%$.

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

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

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

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

In particular:

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

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

International Traffic

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

	Year ended December 31,				
	1999	2000	2001	2002	2003
Total outgoing traffic (millions of minutes)	2,390	2,706	3,015	3,405	3,682
Growth in outgoing traffic (%) ⁽¹⁾	2.2	13.2	11.4	13.0	8.1
Total incoming traffic (millions of minutes)	3,419	3,415	3,845	3,842	3,299
Growth in incoming traffic (%) ⁽¹⁾	15.9	-0.1	12.6	-0.1	-14.1
Total international transit traffic (millions of minutes)	857	1,310	1,825	2,995	4,382
Growth in international transit traffic (%) ⁽¹⁾	7.6	52.9	39.3	64.1	46.3

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

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

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

Incoming international traffic is divided into two general categories: traffic incoming on the fixed network and traffic incoming, or deemed to be incoming, on the mobile network. Such incoming, or deemed to be

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

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

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

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

Interconnection with Other Operators

On March 22, 2003, the National Regulatory Authority approved the introduction of the Network Cap mechanism to regulate interconnection tariffs until the end of 2006. The mechanism will govern the amounts Telecom Italia can charge other operators that want to utilize Telecom Italia's network to provide telecommunications services. Starting with the 2003 Reference Offer (RO), the market will have greater transparency with respect to the arrangements relating to interconnection services, allowing the operators to rely on stable economic values in preparing their business plans.

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

- SGU (Local exchange interconnection and interconnection kit and circuits) = RPI - 8%
- SGT (Single transit interconnection) = RPI - 6%
- 2SGT (Double transit interconnection) and international transit by SGT = RPI - 3.75%
- Ancillary services (i.e. number portability charges, CPS (Carrier Pre-selection Service) charging, etc.) = RPI - RPI

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

With respect to LLU, the National Regulatory Authority in its order has outlined a network cap mechanism to be implemented from January 1, 2004 through December 31, 2006 aimed at moving from historic costs to long run incremental costs (LRIC). LRIC of the access network are likely to be higher than historic costs. Currently, Telecom Italia applies an LLU price (of 8.30/month) which is the lowest in Europe and is significantly lower than the Telecom Italia retail access price. Prior to implementing this price, Telecom Italia's LLU price was 10.79 per month for POTS line and 11.10 per month for ADSL line. Regarding implementation, the Italian LLU market is one of the fastest growing LLU markets in Europe with its 510,000 fully unbundled lines on December 31, 2003 (Italy is second after Germany where LLU started about two years before), representing an increase of 407,000 lines compared with the end of 2002. In addition, Telecom Italia presents the most detailed and complete LLU offer in Europe (physical LLU, sub loop unbundling, shared access and all different kinds of co-location) and Telecom Italia has satisfied all National Regulatory Authority requests in terms of equipment of the sites requested by OLOs.

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

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

- FRIACO: the Telecom Italia Group has been offering this service since 2001.
- Partial circuits: represent partial circuits from customer premises to the OLOs' Point Of Presence (POP), as a segment of an end-to-end leased line. The National Regulatory Authority determined that economic conditions are to be set according to the price ceiling methodology that was established by the European Commission Recommendation C(1999) 3863 of November 24, 1999, and introduced the price ceiling into national legislation with Order No. 10/00/CIR. For speeds and distances of partial circuit different from those included in the Recommendation, the prices are based, according to national as well as European accounting requirements, on Telecom Italia's own costs, evaluated according to the fully allocated current costs model.
- Billing and bad debt service: the Telecom Italia Group must also offer billing to OLOs who decide not to bill the customers (*i.e.* customers that are connected to the network through indirect access service) accessing their non geographic services. The Telecom Italia Group, as required by the National Regulatory Authority, fixed the level of charge for the billing service at 2.9% calculated on the total revenues of each OLOs non geographic service. With respect to bad debt, the level of risk and insolvency is subject to negotiation between Telecom Italia and the OLOs.

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

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

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

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

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

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

Fixed Network

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

Domestic Network

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

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gateway areas. The long distance fixed network includes 3.9 million circuits, while the distribution fixed network includes 105.2 million kilometers of pairs over copper cable. In detail, the national network in statistics at December 31, 2003 was as follows:

Exchange areas	Approximately 10,340
Switching areas	615, served by 628 line SGU (Urban Group Stages)
Gateway Areas	33
Copper access network	105.2 million kilometers-pair
Fiber optic access network	428,741 kilometers-line
Fiber optic carrier network	3.2 million kilometers-line
Direct dialing circuits	3.9 million
Network for direct digital circuits (PARD)	474,690 access points with speed up to 2 Mbit/s
Network for direct analog circuits (PARD)	94,043 access points
Frame Relay Accesses	83,824 gates at 2Mbit/s
PoP main data networks	32

SDH and ATM. The Telecom Italia Group introduced SDH transmission technology into operation in the long distance fixed network in 1996 and introduced such technology into operation for its local fixed network during 1997. These transmission systems are operating on fibreoptics from 155 Mbit/s up to 2.5 Gbit/s. Moreover, in 2002 Telecom Italia began using transmission systems with speed up to 10 Gbit/s. Work on the development of the Arianna network which, by use of the latest generation of SDH technologies and the optical DWDM technology (Dense Wavelength Division Multiplexing) constitutes the basis for the transport network with a high transmission capacity capable of covering the entire Italian territory, continued during 2003. Arianna is based on a SDH rings architecture; since 2000, in order to reduce the number of fibers, DWDM systems have been used to multiply by a factor of 12 up to 40 the available optical fiber band and the current transmission capacity, thus increasing the transport capacity of the connections. In November 2002 Wireline introduced a new generation of Optical Digital Cross Connect on the domestic wireline transmission backbone in order to progress with the transition from Arianna towards the new generation of meshed ASTN (Automatically Switched Transport Network) optical backbone which started during 2003 and will continue during 2004. By using the ASTN approach it is possible to build a multiservice platform with a high level of integration with the IP network. First applications of Metro DWDM systems were developed in the Rome and Milan metropolitan areas.

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

ATM switching technology, introduced in 1996, allows the transfer of information combining data, video and other services over public and private networks both domestically and internationally. Telecom Italia ATM/Frame Relay networks are overall networks that work together as a multiservice network, using SDH transmission systems as a physical layer. The ATM Network allows for the provision of ATM native services with access rates ranking from 2Mbit/s up to 155 Mbit/s. It also acts as a backbone for both the Frame Relay Access network (with access rates ranking from 64 kbit/s up to 2 Mbit/s), and for the DSL (Digital Subscriber Line) Network, used for the provisioning of xDSL services (ADSL High-bit-rate Digital Subscriber Line or HDSL) and SDSL. The ATM/Frame Relay networks allows access to IP and MPLS services (Multi Protocol Label Switching) by customers with access rate ranking from 64 kbit/s to 155 Mbit/s.

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

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

Beginning in 1999, operating systems were developed with the aim of ensuring the offering of new services, optimizing operational activities and pursuing objectives of total quality. Procedures were developed for systems dedicated to supervising traffic for verifying levels, the immediate management of measurements and constant monitoring of the quality of the service provided. In systems that operate the flexible network for data

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

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

Fiber optic Cables. At December 31, 2003, the Telecom Italia Group had installed approximately 3.64 million kilometers of optical fiber for access and transfers, of which approximately one million kilometers were installed on long distance fixed-lines. Fiber optic cables significantly increase the capacity of the network and permit the Telecom Italia Group to provide new advanced services based on the simultaneous transmission of several kinds of signals, such as voice, data and video. To enable the offer of such services, the Telecom Italia Group is planning to introduce fiber optics in its local access network.

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

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

International Network

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

The Telecom Italia Group offers international wholesale services (Voice, Data and IP) and international retail services (Global Corporate Network) for multinational customers utilizing its own cross-border backbone, bilateral links and NNI Agreements (Network Node Interface Agreements).

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

- **PEB** (Pan European Backbone). A fiber optic network 2 fiber pairs, 400 Gbit/s each laid in the main industrialized European countries: Italy, France, U.K., Netherlands, Belgium, Germany, Switzerland, Austria and Spain with a total length of 12,000 km. The cross-border services available for wholesale customers are: Managed Bandwidth, IP Connectivity, International Private Leased Circuit, Global Voice Services, GRX (GPRS Roaming eXchange for Mobile Operator);
- **LAN** (Latin American Nautilus). A high capacity backbone based on an optical fiber ring network both on earth and under sea, 30,000 km long, including the Miami-New York City link. The ring, having optical automatic traffic protection and a bandwidth up to 320 Gbits, links the most important cities of South America to Central and North America;

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- **MED** (Mediterranean Nautilus). A submarine optical ring, in a high-availability network configuration, with a total length of 7,000 km 6 fiber pairs, 64 lambdas (10 Gbit/s each) per fiber pair- linking the main markets of the Central-Eastern Mediterranean area: Italy, Greece, Turkey and Israel. Presently, the optical ring links Catania, Athens, Chania-Crete, Haifa and Tel Aviv.

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

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

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

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

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

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

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

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

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

Retail International Network

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

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

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

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

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The main activities carried out during 2003 have been:

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

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

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

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

Financial data of the main subsidiaries

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

National Subsidiaries				International Subsidiaries			
<u>Atesia</u>	<u>Path.Net</u>	<u>Loquendo</u>	<u>Telecom</u>	<u>HanseNet</u>	<u>Latin</u>	<u>Mediterranean</u>	<u>Med-1</u>
			<u>Italia</u>	<u>Telekom-</u>	<u>American</u>	<u>Nautilus</u>	<u>Group</u>
			<u>Sparkle</u>	<u>munication</u>		<u>Group</u>	

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		Group		GmbH		Nautilus Group		U.S.\$		U.S.\$		U.S.\$	
		(*)											
Gross operating revenues	2003	93	117	15	1,671	102	40	46	63	71	17	20	
		98	93	15	19	83	29	28	64	61	20	19	
	2002	(5.1)	25.8			22.9		64.3		16.4		5.3	
	Change (%)												
Gross operating profit	2003	26	10	1	296	18	4	5	22	25	11	12	
		38	5	0	(30)	22	11	11	26	24	12	12	
	2002	(31.6)	100.0			(18.2)		(54.5)		4.2			
	Change (%)												
Operating income	2003												
	2002	17	9	(2)	144	(24)		(15)	56	(33)	4	4	
	32	4	(1)	(43)	(37)	(13	(6)		53		4	4	
	Change (%)	(46.9)	125.0	(100.0)		35.1	(6	(150.0)		(162.3)			

(*) 2002 data referred to TMI group, before that Telecom Italia's International Wholesale Services business was contributed to Telecom Italia Sparkle on December 31, 2002.

Major 2003 corporate events affecting scope of consolidation

Lisit Informatica. On February 4, 2003, Telecom Italia, in a temporary association of companies with Finsiel and Lutech (Lucchini group), won the bid held by the Lombardy Regional Authority for the supply of goods and services needed to disseminate and manage the Regional Services Card throughout the Lombardy Region. The total value of the bid won by the association led by Telecom Italia, scheduled to last until 2009, is approximately 350 million. Within the framework of the obligations undertaken, Telecom Italia and Finsiel acquired 35.2% of the share capital of LISIT, for a total of 54 million. As at December 31, 2003, the total stake held by Telecom Italia Wireline in LISIT was 24.2%.

Loquendo. In March 2003, Loquendo was transferred to Wireline Business Unit from the IT Group Operating Activity.

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Agreement for the acquisition of Megabeam. In view of the conditions laid down by the Italian Antitrust Authority on August 7, 2003, on September 18, 2003, Telecom Italia annulled the preliminary contract for the acquisition of Megabeam, the first Italian wireless internet service provider, signed on March 10, 2003. Telecom Italia expects to continue to avail itself of the cooperation of Megabeam, with which there is already a commercial agreement covering 19 locations.

Intelcom San Marino. In August 2003, Telecom Italia International acquired the remaining 30% stake in Intelcom San Marino. Subsequently, in December 2003, Telecom Italia International sold its entire 100% stake in the company to Telecom Italia Sparkle, which is part of the Wireline Business Unit.

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

BBNed group. In September 2003, the BBNed group (previously part of International Affairs) moved to the Wireline Business Unit.

Latin American Nautilus S.A. In December 2003, after the recapitalization of the company, Telecom Italia became the sole shareholder of Latin American Nautilus S.A..

Events subsequent to December 31, 2003

- Effective March 15, 2004, Telecom Italia raised the entry level offering for ADSL from 256/128 Kbps to 640/256 Kbps, one of the highest speeds in Europe in terms of uploading or downloading data.
- On March 15, 2004, Telecom Italia, in keeping with its commitment to develop innovative broadband services, launched the video on demand service for computers through the Rosso Alice portal. This portal, which is organized into six areas (films, sport, music, videoclips, games, information and video-community) will offer the service on demand to all Internet users with an ADSL connection. Alice customers can purchase the content through a credit card or by direct debit to their phone bill, whereas other users may only purchase content through a credit card.

Mobile

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

The Mobile Business Unit accounted for gross operating revenues of 11,782 million in 2003, 10,867 million in 2002 and 10,250 million in 2001.

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As of December 31, 2003, the business unit was organized as follows:

National Subsidiaries TIM Telecom Italia Mobile	Mobile International Subsidiaries TIM International N.V.	Affiliated Companies IS TIM T.H.A.S. (Turkey)
S.p.A.	<ul style="list-style-type: none">• TIM Brasil group<ul style="list-style-type: none">- Tele Nordeste Celular Participacoes group (Brazil)- Tele Celular Sul Participações group (Brazil)- Maxitel S.A. (Brazil)- TIM Celular S.A. (Brazil)- Starcel Ltda (Brazil)• TIM Perù S.A.C.• Corporacion Digitel C.A. (Venezuela)• Blah! S.A. (formerly TIMNet.com S.A Brazil)	STET Hellas Telecommunications S.A. (Greece)

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Among the large mobile telecommunications operators in Europe at the end of 2003 TIM had the largest number of lines in its domestic market (source: Mobile Communication magazine) and has been the fastest growing area of the Telecom Italia Group's business for the past several years. Line growth was 11% in 2001, 6% in 2002 and 3% in 2003. Gross operating revenues from TIM totaled 9,469 million, 9,022 million (8,915 million net of Blu merger effect) and 8,357 million in 2003, 2002 and 2001, respectively.

Services Italy. TIM primarily offers digital mobile services as well as its legacy analog service which is being phased out. The GSM digital service, which commenced operations in April 1995, uses digital technology and is the standard throughout Europe. GSM generally provides higher quality transmission than analog service and may be used by customers to make and receive mobile calls throughout Europe and certain other countries. As of May 23, 2004, roaming agreements have been reached with 378 operators in over 203 countries, allowing customers to make and receive calls abroad. See Mobile Tariffs below. The analog service is based on the TACS 900 standard and began operation in 1990. See Cellular Network .

Customers and Lines. The penetration of mobile telecommunications service in Italy is above the Western European average at approximately 99 lines per 100 inhabitants at the end of 2003 and growth rates have been substantially higher than the European average. This compares to a penetration rate of 89 and 94 lines per 100 inhabitants at the end of 2001 and 2002, respectively. The increase is due to innovative services and an increase in customers with multiple lines and the number of operators. TIM's customer base consists of GSM subscribers and customers holding GSM TIM Cards (GSM Prepaid Customers) as well as TACS subscribers and customers holding TACS prepaid services, (TACS Prepaid Customers and together with GSM Prepaid Customers, Prepaid Customers). TIM is in the process of closing down its TACS service and is transitioning its customers to its GSM network. In 2003, TIM had a 27.3% market share of net additional GSM lines, corresponding to 0.8 million of net lines, compared to 1.6 million for Vodafone Omnitel, 1.2 million for Wind and the remaining 0.4 million attributable to H3G (3).

TIM's statistical data excludes 700,000 silent lines. The Italian market, which has a high penetration of prepaid cards, is characterized by certain customers acquiring multiple lines in order to take advantage of specific/time-limited commercial offers. Once these offers expire these customers tend not to continue the use of such lines which is facilitated by the prepaid nature of the arrangement. As a result, TIM excludes the silent lines in order to provide greater consistency between the number of lines managed by the Company and the development of the business.

At December 31, 2003, the number of lines for TIM's GSM and TACS mobile service was approximately 26.1 million (of which 25.5 million were GSM lines, consisting of 2.6 million GSM subscribers and 22.9 million GSM Prepaid lines). As of March 31, 2004, TIM's customer base remained essentially unchanged at 26.0 million lines.

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

	<u>Year ended December 31,</u>				
	<u>1999</u>	<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
	(%)				
TIM Italian geographic coverage					
TACS	83	83	83	83	83
GSM	89	92	94	94	94
TIM Italian population coverage					
TACS	98	98	98	98	98

GSM	99	100	100	100	100
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The table below sets forth, for the periods indicated, selected customer data for TIM's domestic business.

	Year ended December 31,				
	1999	2000	2001	2002	2003
	(number of customers in thousands)				
Lines at period end(1)	18,527	21,601	23,946	25,302	26,076
TACS subscribers	832	495	304	180	95
TACS prepaid lines	2,344	1,950	1,430	815	480
GSM subscribers(2)	2,442	2,485	2,538	2,685	2,595
GSM TIM Prepaid Lines	12,909	16,671	19,674	21,622	22,906
	(in%)				
Customer growth	29.6	16.6	10.9	5.7	3.1
Churn(3)	12.7	15.7	15.6	18.0	13.2
TIM penetration(4)	32.5	37.5	41.6	43.9	45.3
Cellular market penetration(5)	53.1	73.3	89.0	93.7	99.2
	(€)(6)				
Average revenue per line per month(7)	34.9	30.5	29.1	28.8	29.1

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

(2) Commenced GSM services in April 1995.

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

(4) TIM customers per 100 inhabitants.

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

(6) The data for the years ended December 31, 1999 and 2000 was in lire and was translated into euros at the irrevocably-fixed rate of exchange of Lit. 1,936.27 = 1€.

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

The growth in TIM's mobile lines over the five year period reflected in the table above has resulted almost entirely from the marketing success of the GSM TIM Card, a prepaid card which permits the customer to make outgoing calls up to the limit on the card for the 12 months following issuance of the card or the last recharge of the card and receive an unlimited number of calls for the 13 months following issuance of the card or the last recharge of the card. If a GSM TIM Card is not recharged within this 12-month period, the customer will not be able to make outgoing calls but for one additional month such customer will be able to receive incoming calls. The GSM TIM Card can be recharged at any time to permit additional outgoing calls. The GSM TIM Card offers several advantages, including elimination of bad debt charges and lower administration costs, as no statements are sent to customers. Approximately 89.7% of TIM's lines at December 31, 2003, are prepaid.

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

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

	Year ended December 31,				
	1999	2000	2001	2002	2003
	(millions of minutes)				
Total outgoing traffic per month	1,219	1,569	1,795	1,960	2,090
Total incoming and outgoing traffic per month	1,989(1)	2,479(2)	2,815(3)	3,036(4)	3,202(5)
	(% of total)				
Of which:					
TACS(6)	19.5	10.3	5.4	3.0	2.0
GSM(6)	80.5	89.7	94.6	97.0	98.0

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- (1) Includes domestic mobile incoming and outgoing traffic (93.9% of total mobile traffic in 1999 compared to 96.2% in 1998), international traffic (3.2% in 1999 compared to 2.3% in 1998) and roaming traffic (2.9% in 1999 compared to 1.5% in 1998). These data include fixed outgoing traffic to the mobile network.
- (2) Includes domestic mobile incoming and outgoing traffic (90.4% of total mobile traffic in 2000 compared to 93.9% in 1999), international traffic (2.9% in 2000 compared to 3.2% in 1999) and roaming traffic (6.7% in 2000 compared to 2.9% in 1999). These data include fixed outgoing traffic to the mobile network.
- (3) Includes domestic mobile incoming and outgoing traffic (92.8% of total mobile traffic in 2001 compared to 90.4% in 2000), international traffic (2.7% in 2001 compared to 2.9% in 2000) and roaming traffic (4.5% in 2001 compared to 6.7% in 2000). These data include fixed outgoing traffic to the mobile network.
- (4) Includes domestic mobile incoming and outgoing traffic (94.5% of total mobile traffic in 2002 compared to 92.8% in 2001), international traffic (2.3% in 2002 compared to 2.7% in 2001) and roaming traffic (3.2% in 2002 compared to 4.5% in 2001). These data include fixed outgoing traffic to the mobile network.
- (5) Includes domestic mobile incoming and outgoing traffic (95.5% of total mobile traffic in 2003 compared to 94.5% in 2002), international traffic (1.9% in 2003 compared to 2.3% in 2002) and roaming traffic (2.6% in 2003 compared to 3.2% in 2002). These data include fixed outgoing traffic to the mobile network.
- (6) Includes traffic from Prepaid Customers.

Mobile Tariffs. TIM's mobile customers (other than Prepaid Customers) are charged a one-time connection fee, a monthly basic charge and traffic fees for calls, as well as a monthly government tax. Prepaid Customers are charged an initial connection fee of 26 for the GSM TIM Card and TACS prepaid service and are required to pay a fee ranging from 5 to 1 to the dealer for each recharge, according to the cost of each recharge. No other connection or subscription fees or taxes are payable by Prepaid Customers. Mobile customers (including Prepaid Customers) must purchase their own mobile telephone handsets. TIM does not subsidize the cost of mobile telephone handsets to its customers and does not intend to do so in the foreseeable future. In 2003, approximately 75% of revenues from TIM mobile services (net of access charge) were derived from traffic charges, 5% from sales and rental of equipment, 11% from VAS and 9% were miscellaneous revenues (subscription and connection fees).

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

TIM enhanced its voice offers during 2003 in order to stimulate voice usage, traffic among TIM customers (with a positive effect on profitability) and increase customer loyalty. Some of the offers are:

- **Chiama Ora** : a service aimed to increase usage opportunities, which notifies the customers via SMS that the number called, originally not reachable, is available again;
- **Sunday TIM** aimed to increase net traffic on holidays and to optimize network utilization;
- **2 in 1** : that provides customers with two different numbers on the same SIM card, the service's goal is to encourage Number Portability and boost usage and ARPU;
- **Office network** an offer tailored for the SoHo segment to boost traffic among TIM customers (discount on traffic between a network of people defined by customers).

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

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

At the beginning of 2002, TIM launched the first exclusive service which allowed TIM customers to reverse billing charges to a rechargeable or contract TACS or GSM TIM mobile, or to Telecom Italia fixed network numbers.

In May 2002, TIM introduced the following new tariff plans: Unica and Unica10; customers can personalize their own tariff choosing between two options: SuperAutoricarica (self recharge from all numbers) and Trio, a special tariff for three TIM numbers or two TIM numbers and a Telecom Italia fixed network number.

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GSM and TACS customers are charged on the basis of a per-seconds billing system paying for the actual duration of the call plus a call setup charge of 0.1 (which is not charged when free minutes are being used). At the end of 1997, TIM also introduced local tariffs. From time to time, TIM offers promotional packages to attract additional customers.

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

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

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

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

In October 2003, TIM was the first mobile operator to launch mobile TV. The service is currently available only on a limited number of handsets (Nokia 3650/3660/6600 and Nokia N-Gage). The services contents are available pursuant to agreements between TIM and major TV channels such as RAI, La 7, MTV, CNBC and Coming Soon Television.

Billing. TIM's customers (other than Prepaid Customers) are billed in a staggered bimonthly billing cycle. TIM endeavors to minimize bad debts by implementing a credit check on each customer at the time of sign-up and by requiring certain customers to post a security deposit. In addition, if payment is not received, the customer is notified accordingly and his or her ability to place outgoing calls is interrupted. If no payment is received, all services are terminated. The average rate of innovative payments (credit cards, Banco Posta...) made by customers (other than Prepaid Customers) rose, in 2003, to 83% of the total payments.

Marketing and Distribution. TIM believes that its active marketing programs, extensive customer service and distribution network (primarily a nationwide network of independent dealers) and responsiveness to customer needs provide it with a significant competitive advantage. At December 31, 2003, there were 1,445 distribution partners, with 4,188 sales points (including 62 Telecom Italia Group outlets marketing TIM products and 27 shops directly owned by TIM). As of December 31, 2003, 4,191 TIM employees (about 41.8% of its total workforce) were involved in customer service activities.

Cellular Network. TIM's GSM network consists of 12,720 radio base stations and 651,544 radio channels (an increase of 3.4% over 2002). The Telecom Italia Group believes that as a result of TIM's enhancement of the GSM service and increased coverage, TIM's network is in line with the best European GSM networks. TIM's TACS network consists of 2,715 radio base stations and 40,090 radio channels. TIM has reduced the level of investment in its TACS network as the number of TACS customers has decreased.

Services International. TIM continued to consolidate its role in the international mobile market during 2003. TIM International's presence is now primarily concentrated in Latin America and in the Mediterranean Basin. In December 2003, in addition to customers in Italy, TIM had 18.4 million total managed lines in its subsidiaries abroad (including minorities), corresponding to 9.5 million proportionate lines (weighted for TIM's stake in each company). 45.3% of TIM's international lines are European mobile lines (other than Italian mobile lines) while 54.7% are Latin American mobile lines. See Companies Controlled by TIM International .

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

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

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

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

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

- increase roaming services and correlated voice and data traffic;
- reduce costs, leveraging on stronger purchase power towards suppliers;
- improve customer proposition by offering state-of-the-art/exclusive terminals for FreeMove Alliance members. Preferential supply agreements have already been signed with Siemens and Motorola;
- strengthen operators brand and positioning by means of higher quality service perception; and
- improve competitive positioning on the Multinational company market by offering one stop shop solutions.

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

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

Holdings of International Operations

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As a result of a corporate reorganization completed at the end of 2000, TIM acquired 100% of STET Mobile Holding (SMH), the international holding company of the Telecom Italia Group holding substantially all of the Telecom Italia Group s wireless investments outside of Italy. On December 28, 2001, SMH merged with TIM International, the holder of stakes in Digitel and Is TIM. TIM International is managed by TIM and the international results have been fully consolidated with TIM s results since January 1, 2001. In January 2001, TIM Brasil, a wholly owned subsidiary of TIM International, was formed to act as a sub holding company for the subsidiaries which acquired PCS licenses in Brazil (TIM Celular Centro Sul, TIM Sao Paulo and TIM Rio Norte). In November 2001, TIM International s stake in Bitel (the majority shareholder of Tele Nordeste Celular and Tele Celular Sul) was contributed to TIM Brasil. In December 2002, within the framework of the corporate reorganization process, TIM Sao Paulo was merged with TIM Celular Centro Sul and TIM Rio Norte and, in January 2003, changed its name to TIM Celular. In September 2003, Bitel Participações merged its controlling company, TIM Brasil S.A., and changed its name to TIM Brasil Serviços e Participações S.A. In December 2003, following the approval of the Boards of Directors of the Brazilian companies, owners of the 80% interest of Blah! S.A. - formerly TIMNet.com S.A. (Tele Nordeste Celular, Tele Celular Sul, Maxitel and TIM Celular), such stake has been sold to TIM International N.V., that became the sole owner of Blah! S.A.

Digitel and Maxitel, whose controlling stake was acquired at the end of 2000 have been fully consolidated with TIM s results since January 1, 2001.

At December 31, 2003, the overall number of TIM lines calculated on a proportionate basis, in Italy and internationally was approximately 35.6 million. There are approximately an additional 2.2 million equity mobile lines calculated on a proportionate basis that are part of the Telecom Italia Group.

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

Controlled Operations

<u>Country</u>	<u>Operator</u>	<u>Percentage interest of TIM International</u>	<u>Total Wireless lines per operator at December 31, 2003</u>
(millions)			
Europe			
Greece	STET Hellas	81.40	2.4
Latin America			
Brazil	Maxitel		
	Tele Nordeste	100.00(1)	1.6
	Celular(*) Tele	22.52(2)	2.2
	Celular Sul(*)	22.21(3)	2.1
	TIM Celular	100.00	2.5
Perú	TIM Perú	100.00	0.6
Venezuela	Digitel	67.12(4)	1.2

(*) Represents total of shares held; these entities are consolidated as the Group owns over 50% of the voting common stock.

(1) In February 2002, TIM Brasil acquired 10% of ordinary shares of Maxitel, corresponding to 3.33% of the total capital.

(2) During 2003, the interest in Tele Nordeste Celular increased by 1.34%.

(3) During 2003, the interest in Tele Celular Sul increased by 1.53%.

(4) In May 2003, TIM International increased its interest in Digitel, through a share capital acquisition, by 0.56%. On April 20, 2004, TIM signed an agreement to acquire the remaining 32.88% of Digitel's share capital from its minority shareholders. Upon completion of the transaction, TIM International will own 100% of Digitel's share capital. See Recent Developments During 2004 TIM's stake in Digitel.

Affiliated Companies

<u>Country</u>	<u>Operator</u>	<u>Percentage interest of TIM International</u>	<u>Total Wireless lines per operator at December 31, 2003</u>
(millions)			
Europe			
Czech Republic	T-Mobile CZ (formerly Radiomobil)	4.35	3.9
Turkey	Aria Is TIM	40.00(1)	2.0

(1) On February 19, 2004, Is TIM was merged with Aycell. The new company (TT&TIM) resulting from the merger is currently held by TIM International (40%), Turk Telekom (40%) and by the Is Bank group (20%). Please see below Other investments held by TIM International Turkey.

Companies Controlled by TIM International

Europe

Greece

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

In July 2001, the company was awarded a UMTS license, for 145 million (of which approximately 101 million has already been paid) and a DCS 1800 license for 26 million. At December 31, 2003, STET Hellas had approximately 2.4 million lines. In 2003, operating revenues were 805 million against 689 million in 2002, gross operating profit was 287 million compared to 255 million in 2002 (a 12.5% increase) and operating income was 166 million against 131 million in 2002 (an increase of 26.7% compared to 2002). The improvement in the economic performance was due to the increase of the revenues, mainly due to significant growth in outgoing traffic.

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In January 2004, STET Hellas commercially launched UMTS services in Greece. STET Hellas also announced, in February 2004, the change of its commercial brand to TIM. The adoption of the re-branding is a joint strategic initiative of STET Hellas and TIM to strengthen the image of the Greek operator.

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

Latin America***Brazil***

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

Tele Nordeste Celular Participações group. A controlling interest in Tele Nordeste Celular Participações, a supplier of mobile telephone services in the regions of Alagoas, Ceará, Paraíba, Pernambuco, Piauí and Rio Grande do Norte, was acquired in 1998. At the end of 2003, in a market with a penetration level of 16%, Tele Nordeste had 2.2 million lines (an increase of 12.8% compared to 2002), corresponding to a market share of approximately 47%.

In 2003, Tele Nordeste Celular reported operating revenues of Brazilian reais 1,080 million (€ 311 million), an increase of 9.8% in local currency compared to 2002; gross operating profit of Brazilian reais 509 million (€ 147 million), a decrease of 2.7% in local currency compared to 2002; and operating income of Brazilian reais 279 million (€ 80 million), an increase of 3.0% in local currency compared to 2002.

Tele Celular Sul Participações group. A controlling interest in Tele Celular Sul Participações, a mobile telephone operator in the states of Paraná, Santa Catarina and in the city of Pelotas, was acquired in 1998. In 2003, Tele Celular Sul had 2.1 million lines (an increase of 19.3% compared to 2002) representing an overall market share of 55%. In 2003, Tele Celular Sul reported operating revenues of Brazilian reais 1,202 million (€ 346 million), an increase of 19.0% in local currency compared to 2002; gross operating profit of Brazilian reais 486 million (€ 140 million), an increase of 15.2% in local currency compared to 2002; and operating income of Brazilian reais 245 million (€ 71 million), an increase of 27.6% in local currency compared to 2002.

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

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

At the end of 2003, Maxitel had 1.6 million lines (an increase of 15.4% compared to 2002).

In 2003, Maxitel reported operating revenues of Brazilian reais 890 million (256 million), an increase of 17.9% in local currency compared to 2002, due to an increase in traffic; gross operating profit of Brazilian reais 316 million (91 million), an increase of 7.8% in local currency compared to 2002. Operating income was Brazilian reais 62 million (18 million).

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TIM Celular. On February 13, 2001, TIM's subsidiaries TIM Sao Paulo and TIM Celular Centro Sul acquired PCS licenses in Brazil respectively in the regions of São Paulo and in the Distrito Federal, in the middle/west and south region. On March 13, 2001, TIM Rio Norte acquired PCS licenses in the Northern and in the Rio de Janeiro and Espirito Santo states. On October 18, 2002, the three companies launched GSM services. In December 2002, within the framework of the corporate reorganization process, TIM Sao Paulo merged with the other two companies and, in January 2003, changed its name to TIM Celular.

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

At the end of 2003, TIM Celular had 2.5 million lines. In 2003, TIM Celular reported operating revenues of Brazilian reais 1,258 million (362 million); a loss in gross operating profit of Brazilian reais 833 million (240 million) compared to a loss of Brazilian reais 472 million in 2002; and an operating loss of Brazilian reais 1,278 million (368 million) compared to a loss of Brazilian reais 521 million in 2002.

Perú

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

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

At the end of 2003, TIM Perú had 623,000 lines (an increase of 57.7% compared to 2002).

In 2003, TIM Perú reported operating revenues of 502 million Nuevo Soles (128 million), a gross operating profit of 26 million Nuevo Soles (6 million) and an operating loss of 128 million Nuevo Soles (32 million) against an operating loss of 201 million Nuevo Soles (61 million) in 2002.

Venezuela

In December 2000, TIM acquired a 56.6% stake in Digitel, a Venezuelan mobile operator. The amount paid for this acquisition was approximately US\$363 million (of which approximately US\$107 million was in the form of a capital increase and the balance was in the form of a share purchase). In December 2002, TIM International acquired a further 10% of Digitel's share capital for 32 million. In May 2003 TIM International acquired a further 0.56% of the company shares, consequently, as of December 31, 2003 the TIM group's interest in Digitel increased to 67.12%. Digitel was awarded a 900 MHZ 20-year renewable GSM license in January 1998 and is operating in the Venezuelan Central Region, which, including Caracas and other major cities, is the most important economic region of Venezuela, with 60% of the national

GDP.

In 2002, Digitel changed its network architecture with the choice of Nokia as a main supplier, updated its technologies for prepaid services and launched GPRS and MMS services.

At the end of 2003, Digitel had approximately 1.2 million lines (an increase of 29% compared to the end of 2002).

In 2003, Digitel reported operating revenues of 299 billion Bolivares (148 million), an increase of 14.7% in local currency against operating revenues of 260 billion Bolivares in 2002; gross operating profit of 90 billion Bolivares (45 million) compared to 51 billion Bolivares in 2002; and an operating loss of 20 billion Bolivares (10 million), an improvement of 34.5% against an operating loss of 30 billion Bolivares in 2002.

For further details about pending litigation and other developments relating to Digitel and TIM International, please see Events subsequent to December 31, 2003 and Item 8. Financial Information Legal Proceedings for further details.

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Other investments held by TIM International

Czech Republic

The Telecom Italia Group holds a 7.16% interest in C-Mobil B.V., a company which owns a 60.76% interest in T-Mobile CZ (previously known as Radiomobil), a mobile telecommunications operator, which in March 1996 won a GSM license in the Czech Republic.

As of December 31, 2003, T-Mobile CZ had more than 3.9 million customers. T-Mobile CZ had operating revenues of 768 million and gross operating profit of 339 million in 2003.

Turkey

In line with its expansion strategy in the Mediterranean Basin, in April 2000, the Telecom Italia Group was awarded a mobile GSM 1800 license in Turkey. This license was acquired, at a price of US\$ 2,525 million, through a special consortium (49% owned by Telecom Italia and 51% by Is Bank, the leading private bank in Turkey, in compliance with restrictions imposed by local laws about foreign investments). The second license was awarded to the fixed network operator (Turk Telekom) at the same time, according to the terms of the bid.

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

At the end of 2003, *Aria Is TIM* had a customer base of approximately 2 million lines and it reported operating revenues of 211,013 billion Turkish lire (121 million) and an operating loss of 759,490 billion Turkish lire (435 million). These results are due to the consequence of the difficulties faced by *Aria Is TIM* in developing its mobile business, because of the Turkish regulatory scenario. In fact beginning with the award of the license, some measures which should have fostered effective competition and permitted a new entrant to compete against incumbent operators (roaming arrangements in particular), did not effectively take place. These measures are essential in the light of international experience to foster competition and pursuant to applicable legislation in Turkey. *Aria Is TIM* and its shareholders made repeated and formal efforts to have the situation rectified but was *de facto* prevented from entering the Turkish mobile telephony market, thereby infringing the terms and conditions of the tender. *Aria Is TIM* filed a request for arbitration with the International Chamber of Commerce against the authority for telecommunications which, as a result of the joint venture with Turk Telecom described below, has since been discontinued.

From a financial standpoint, at the end of 2002, Telecom Italia, in conjunction with TIM, concluded that the competitive conditions which would permit TIM to earn a return of investment did not exist. Facing this situation Telecom Italia and TIM wrote off their investment in *Aria Is TIM* in full. The investment held in *Aria Is TIM* was written down (extraordinary loss of 1,491 million) and a provision was added to the reserve for risk and charges related to *Aria Is TIM* (850 million) against the guarantees provided by the Telecom Italia Group to financial institutions and suppliers as creditors of *Aria Is TIM* and the loans to *Aria Is TIM* by the Telecom Italia Group.

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On May 13, 2003, TIM International signed a Term Sheet with Turk Telekom (the fixed line operator) outlining a set of guidelines for the integration of Aria - Is TIM and Aycell (the 4th Turkish mobile operator wholly owned by Turk Telekom). The agreement aims at obtaining significant operating and financial synergies through the combination of the two companies. On February 19, 2004, the merger of Aria - Is TIM with Aycell was completed after receipt of required regulatory approvals. Turk Telekom and TIM each hold a 40% stake in the new joint venture, known as TI&TIM, and Is Bank Group holds the remaining 20%. TI&TIM will start to operate under the two brands of Aria and Aycell, which, together, have a total customer base of about 4.5 million customers representing 15% of the total market, and TT&TIM's ambition is to compete for the leading position in the Turkish market.

TIM's contribution to the new joint venture, TT&TIM, consisted solely of its equity interest in Aria-Is TIM, which, as mentioned above, had been written off in full at December 31, 2002. No new investment has been made by TIM in TT&TIM as of the date of this report. Based on its current knowledge, the previous accounting adjustments, TIM's current investment plans and TT&TIM's current business plan, Telecom Italia does not expect TT&TIM's operating results to have any material impact on Telecom Italia's consolidated results of operations or financial condition over the next three years.

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

		National Subsidiaries	
		TIM	
		Historical	Pro Forma (1)
		Millions of Euro	
Gross operating revenues	2003	9,469	8,915
	2002	9,022	6.2
	Change (%) ⁽²⁾		
Gross operating profit	2003	5,035	4,529
	2002	4,404	11.2
	Change (%) ⁽²⁾		
Operating income	2003	3,863	3,323
	2002	3,153	16.3
	Change (%) ⁽²⁾		

(1) Pro forma income statement data are net of effects arising from the incorporation of Blu.

(2) Percentage calculation based on pro forma 2002 compared to historical 2003.

International Subsidiaries

						Other
						subsidiaries
						STET Hellas
						Telecommuni-
						cations Group
(million)	Tele Nordeste Celular Participações Group	Tele Celular Sul Participações Group	Maxitel S.A.	TIM Celular S.A.	TIM Perù S.A.C.	Corporacion Digitel C.A.

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		Reais		Reais		Reais		Reais		Nuevo Soles		Bolivares		
Gross operating revenues	2003	311	1,080	346	1,202	256	890	362	1,258	128	502	148	298,681	805
	2002	355	984	364	1,010	273	755	39	108	93	308	177	260,378	689
	Change(%)		9.8		19.0		17.9						63.0	14.7
Gross operating profit	2003	147	509	140	486	91	316	(240)	(833)	6	26	45	90,207	287
	2002	189	523	152	422	106	293	(170)	(472)	(29)	(95)	35	51,355	255
	Change(%)		(2.7)		15.2		7.8		(76.5)				75.7	12.5
Operating income	2003	80	279	71	245	18	62	(368)	(1,278)	(32)	(128)	(10)	(19,702)	166
	2002	98	271	69	192	27	74	(188)	(521)	(61)	(201)	(20)	(30,070)	131
	Change (%)		3.0		27.6		(16.2)						36.3	34.5

Major 2003 corporate events/scope of consolidation

On March 28, 2003, STET Hellas acquired from IT Telecom S.p.A. the full stake in Telesoft Hellas S.A., a company that developed software for telecommunications, and, as of November 14, 2003, merged it into STET Hellas.

On September 26, 2003, TIMNet.com S.A. changed its name to Blah! S.A., thus completely identifying the name of the company with its commercial trademark.

On September 30, 2003, the merger of TIM Brasil S.A. and Bitel Participações S.A. became effective. The acquiring company took the name of TIM Brasil Serviços e Participações S.A. (in shortened form, TIM Brasil). The transaction is part of the process currently underway to simplify the Group structure.

In December 2003, following the approval of the Boards of Directors of the Brazilian companies, owners of the 80% interest of Blah! S.A. - formerly TIMNet.com S.A. (Tele Nordeste Celular, Tele Celular Sul, Maxitel and TIM Celular), such stake was sold to TIM International N.V., that became the sole owner of Blah! S.A..

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Events subsequent to December 31, 2003

TIM's stake in Digitel

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

Merger of the Tele Nordeste Celular Participações group companies and rationalization of the Brazilian subsidiaries

On January 30, 2004, the extraordinary Shareholders' Meeting approved the merger of the operating companies controlled by Tele Nordeste Celular (Telasa Celular, Telpa Celular, Telem Celular, Teleceará Celular and Telepisa Celular) by Telpa Celular. As a result, Telpa Celular's name was changed to TIM Nordeste Telecomunicações S.A..

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

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

The merger envisages the issue of new shares by Tele Celular Sul Participações which will be assigned, with the same class designation, to the shareholders of Tele Nordeste Celular Participações. The merger will be notified to the Agencia Nacional de Telecomunicações (Anatel) in Brazil and the new shares will need to be registered with the SEC. At the end of the transaction, Tele Celular Sul Participações will be controlled by TIM Brasil and its shares will continue to be listed on both the Bovespa and the NYSE.

Merger of Aria Is Tim

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On February 19, 2004, the merger of Aria Is Tim the mobile operator owned by TIM (49%) and Is Bank Group (51%) with Aycell, the GSM operator entirely held by the state owned fixed-line operator Turk Telekom, was completed.

The integration process, which began last May with the execution of an agreement establishing the guidelines for the merger of Aria Is Tim and Aycell, was completed after all the approvals of the relevant Authorities were obtained.

TIM and Turk Telekom own a 40% stake in the new company (TT&TIM) each and Is Bank Group holds 20%.

Today the two companies have a joint customer base of about 4.5 million customers representing 15% of the total market, and the ambition of TT&TIM, which will start to operate under the two brands of Aria and Aycell, is to compete for the leading position on the Turkish market.

Acquisition of Innovative Services Business Segment

The sale by IT Telecom S.p.A. of its Innovative Services Business Segment to TIM S.p.A. was completed as of April 1, 2004; the activities of this business segment are conducted in the innovative services field, based on

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IP networks and oriented towards the business and mass-market sectors, and they are related to the development and maintenance of software for telecommunications. The sale price, based on an evaluation by Milestone Advisory House S.p.A., was agreed at 23 million, 551 staff units were also transferred.

Contribution of Specialized Business Software Segment

In March 2004, under Telecom Italia Group's program for information technology, TIM contributed a business segment which develops and maintains software applications in the SAP environment to the company Shared Service Center, a limited liability consortium company. The value of the business segment was determined by an expert appointed by the Milan Courts at 65 thousand.

South America

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

As of December 31, 2003, LAO was organized as follows:

LATIN AMERICA OPERATIONS		
	Subsidiaries	Affiliated
• TIM Brasil Group	• Entel Chile Group	• Telecom Argentina Group
• TIM Perù S.A.C.	• Entel Bolivia Group	
• Corporacion Digitel C.A. (Venezuela)	• Telecom Italia America Latina	

A description of the companies providing mobile services (TIM Brasil group, TIM Perù and Corporacion Digitel) is provided under Mobile Companies Controlled by TIM International Latin America .

International Strategy in Latin America

The Telecom Italia Group's international strategy in Latin America has the following objectives:

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

Latin America Companies Controlled by Telecom Italia International

Chile

Telecom Italia International has a 54.76% stake in Entel Chile which was until 1994 the monopoly long distance operator in Chile. During the last ten years the Entel Chile Group has significantly enlarged its activities becoming a full operator maintaining its leadership positioning in the long distance segment while introducing mobile services, through its two PCS licenses acquired in 1998, as well as local, internet and data services.

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Since introducing mobile services, Entel Chile has achieved the leading position in wireless telecommunications with a 40.5% market share representing approximately 2,684,000 mobile lines at the end of 2003 (an increase of 17.1% compared to 2002).

Consolidated operating revenues during 2003 were 962 million representing a significant decline (a decrease of 21.3%) against 2002. During this same period the Chilean peso declined in value by 19.8% against the Euro. In local currency terms Entel Chile also recorded a decrease in revenues of 5.8% due to a sharp decline in the wireline segment (a decrease of 15.5%), mainly due to the negative performance of long distance operator Americatel (an affiliate of the Chilean Group in the USA) which has been negatively impacted by the unexpected strengthening of the competitive position of the Competitive Local Exchange Companies (CLECs), and the continuous growth of mobile revenues (an increase of 6.4%).

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

The operating profit of 2003 reached 134 million, an increase of 5.7% against 2002 in local currency; return on investments (ROI) reached 10.5% at the consolidated level, and net financial debt was reduced by 22.3%, lowering the debt ratio (net financial debt/net invested capital) to 40% (48% in 2002).

During the second half of 2003, Chile began to show higher Gross Domestic Product (GDP) growth rates implying better demand expectations for 2004 and also taking account of the overall stable political situation. Nevertheless, mobile tariff regulation (January 2003) implies a negative impact on wireless revenues, due to a decrease in access charges to the mobile networks of around 30%, which will be offset only partially by traffic demand elasticity (calls from the fixed network), price increases and growth of mobile VAS revenues.

During 2002, Entel Chile launched a WLL (Wireless Local Loop) business in order to penetrate the growing broadband market. However, during 2003, Entel Chile faced significant competition in broadband from the CATV (Cable TV) operators, as well as the ADSL offer of the incumbent (now Telefonica Chile). The Entel Chile Group within its wireline activities is still considering how to cope appropriately with its lack of local access.

Bolivia

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

During 2003, operating revenues were 151 million, a decrease of 18.8%, primarily attributable to the weakening of the Bolivian currency against the euro, although revenues in local currency increased by 4.1%. Revenue growth was mainly driven by the mobile business (an increase of 23.5%) where the company maintains its strong market leadership (75%), while the wireline business registered a decrease of 10.8% due to the general market contraction related to an unstable political and economic environment during the course of 2003, as well as to aggressive competition.

An efficiency plan applied to both operating and capital expenditures together with a significant reduction of the interconnection costs resulted in important improvements in productivity and profitability. The 2003 gross operating profit was 71 million or 26.6% over 2002 and 47% over revenues.

As of December 31, 2003, Entel Bolivia had 783,000 mobile lines, up 69.5% from the end of 2002, and 49,000 fixed lines subscribers, substantially stable when compared with 2002.

Latin America Affiliated Companies

Nortel Inversora

In December 2003, the France Telecom Group and the Telecom Italia Group contributed their respective stakes in Nortel (corresponding in total to 67.78% of its capital) to a new Argentinean registered holding company, Sofora Telecomunicaciones S.A. which had been organized in September 2003 and was held 50% by

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the Telecom Italia Group and 50% by the France Telecom Group. On December 19, 2003, France Telecom transferred to the Wertheim Group (Argentinean Group) a 48% stake in the Sofora Telecomunicaciones share capital for U.S.\$125 million, including a call option on the remaining 2%, exercisable from January 31, 2008 to December 31, 2013. In order to discipline their relationship, Telecom Italia, Telecom Italia International and Wertheim Group executed a shareholders' agreement. Moreover, Telecom Italia International purchased from Wertheim Group two call options for U.S. \$60 million. The first one for the purchase of 48% of Sofora Telecomunicaciones share capital which can be exercised within 30 business days after December 31, 2008, and the second one for the purchase of an additional 2% of Sofora Telecomunicaciones share capital, which can be exercised between December 31, 2008 and December 31, 2013.

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

Nortel currently owns 54.74% of Telecom Argentina, which until October 1999 operated the telecommunications network in the northern part of Argentina (including Buenos Aires) among others, fixed-line and mobile telecommunications operations, international services, data transmission services, value-added services and directories publishing. Since October 1999, the Argentinean market has been progressively liberalized, and as a consequence of this Telecom Argentina has expanded its operations to the entire national territory. In June 1999, Telecom Argentina also expanded its mobile telecommunications services, by acquiring new licenses in the PCS technology, for a total amount of U.S.\$327 million.

At the end of 2003, Telecom Argentina had accumulated 3.3 million fixed-line network subscribers. Its subsidiary Telecom Personal (including Nucleo Paraguay) which is a leading company in the wireless segment (both in revenues and customers), accumulated more than 3.1 million mobile lines (81% with prepaid cards), with a market share of 34% in Argentina. The group is moving to GSM technology with an investment of U.S.\$26 million during 2003.

In the Internet sector, there were approximately 200,000 subscribers (155,000 access clients and 45,000 broadband clients with a market share of 19%).

During 2003, the Argentine economy recovered partially from the significant economic decline which occurred during 2002. As a result, Telecom Argentina's fixed clients increased by 2% compared to December 2002. The mobile segment recovered strongly during 2003, both in traffic terms (an increase of 21%) and clients (an increase of 15%). However, the partial political economic recovery was due to growth in the international environment (particularly high commodity prices and low interest rates) and not to structural changes in the country. The country remains in default, negotiating with the International Monetary Fund (IMF) and its private creditors. Negotiations with the national government on applicable tariff to fixed telephony is pending.

As a result of the economic recession in February 2002, Telecom Argentina hired Morgan Stanley as financial advisor to explore restructuring alternatives to reduce its outstanding debt. Telecom Argentina defaulted on certain indebtedness in April 2002 and stopped paying interest on its debt in June 2002. As part of its restructuring plan, during 2003, based on a voluntary tender offer that terminated on June 2, 2003, (with a subscription rate of 44%), Telecom Argentina repurchased U.S.\$292 million principal amount of its debt using cash of U.S.\$161 million at a price of 55% of face value. In addition Telecom Argentina paid the full amount of the interest accrued as of June 24, 2002 and 30% of the interest accrued from June 25, 2002 to December 31, 2002.

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On January 9, 2004, Telecom Argentina announced its proposal for a comprehensive restructuring of all of its outstanding unsecured financial debt. Telecom Argentina proposes to implement its proposal pursuant to an *Acuerdo Preventivo Extrajudicial*, or an out-of-court restructuring agreement governed by Argentine law (*APE*).

Under the proposal, Telecom Argentina proposes to restructure all of its outstanding unsecured financial debt by issuing new unsecured notes with new terms and/or by paying cash consideration in accordance with the different options included in the proposal. The proposal has been filed with the relevant authorities in Argentina, USA and Italy in May; once due authorizations and clearance are received, solicitation for creditors' consent to the restructuring will start.

In 2003, Telecom Argentina continued to implement a cost and investment optimization process in order to improve cash flow. The use of this strategy is expected to continue for the foreseeable future.

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In 2003, the Telecom Argentina group recorded consolidated operating revenues of Argentine Pesos 3,746 million (1,123 million). The gross operating profit was Argentine Pesos 2,218 million (665 million) and the operating income was Argentine Pesos 281 million (84 million).

Financial data of the main subsidiaries/affiliated companies

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

(million)		Subsidiaries				Affiliated	
		Entel Chile Group		Entel Bolivia Group		Telecom Argentina Group	
			Pesos		Bolivians		Pesos
Gross operating revenues	2003	962	750,980	151	1,312	1,123	3,746
	2002	1,223	797,171 (5.8)	186	1,260	1,127	3,983 (6.0)
	Change (%)						
Gross operating profit	2003	336	262,344	71	615	665	2,218
	2002	381	248,256 5.7	72	489	684	2,417 (8.2)
	Change (%)						
Operating income	2003	134	104,289	11	97	84	281
	2002	151	98,678 5.7	2	15	1	2
	Change (%)						

Major 2003 corporate events/scope of consolidation

During 2003, the Telecom Italia Group, through Telecom Italia International (the primary vehicle by which the Telecom Italia Group holds its international wireline and integrated mobile/fixed-line investments), continued pursuing its targets, supporting the growth of its majority owned subsidiaries and focusing on rationalization of other investments.

The following key transactions were finalized during 2003:

- In January 2003, the Telecom Italia Group disposed of its stake (28.57%) held in GLB Servicios Interativos (Globocom) to TVGlobo LTDA for a consideration of U.S.\$ 15 million. As a result of such transaction, the Telecom Italia Group realized a net gain of 4 million.
- In September 2003 and December 2003, the reorganization of the share ownership structure of Nortel. See Latin America Affiliated Companies Nortel Inversora.

Events subsequent to December 31, 2003

Effective March 1, 2004, under the plan to consolidate Telecom Italia's presence in Latin America, Latin America Operations was disbanded and Telecom Italia Latam assumed the role of delocalized corporate office at continental level in Latin America.

Internet and Media

During 2003, the Internet and Media Business Unit was significantly reorganized as a result of the spin-off and sale of New SEAT through which Telecom Italia disposed of its directories, directories assistance and business information business segments of the SEAT group. As a result of this disposition the remaining businesses of the Internet and Media Business Unit, now held through Telecom Italia Media, provide access and content services to retail and business customers through the Internet, television and telephone.

Starting from August 8, 2003, the Internet and Media Business Unit operates in the following segments: internet services, television, office products and services and business information and professional publishing.

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As of December 31, 2003, the Business Unit is organized as follows (the table shows the main companies/consolidated activities):

INTERNET AND MEDIA				
INTERNET	TV	NEWS	OFFICE PRODUCTS	PROFESSIONAL PUBLISHING
Tin.it Matrix	Holding Media e Comunicazione Group	TM News (*)	Buffetti Group CiPi (**)	GPP

* Purchased on September 30, 2003.

** Sold on January 29, 2004.

Internet Services

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

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

Internet Access Services

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

Tin.it offers two principal access subscription plans:

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

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At December 31, 2003, Tin.it's subscriber base amounted to approximately 2.5 million active users (defined as users who connect to the Internet at least once every 45 days).

<u>Million</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>
Active users(1)	1.8	2.2	2.5

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

During 2003, Telecom Italia Media enhanced its Tin.it brand and range of products, developing, in particular, the ADSL connection based on usage. This enhancement marked an increase in the customer base (Alice, ADSL of Telecom Italia, +Tin.it).

Portal Services

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

Virgilio is a leading Italian portal, with approximately 6.6 billion web page views in 2003 and approximately 5.3 billion web page views in 2002, that caters to the Italian speaking community on the Internet. Management believes that Virgilio, which has been on-line since July 1996, is one of the most complete Italian portals. It contains a search engine and a websites index, and it centralizes services in various interest areas such as stock quotes, weather forecasts, TV guides, games, chats advertisements and shopping. In order to simplify the use of information, Virgilio offers personalized, interactive services that correspond to the requirements of individual customers.

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In 2003, Virgilio launched the new version of *Virgilio Ricerca* with a significant increase in traffic and turnover. Product innovation is one of the most important basis for future evolution of Virgilio and it represented the primary focus for investment during 2003.

Virgilio Viaggi, the on-line travel agency, was entirely renewed and launched just before summer 2003 with increasing levels of traffic and advertisement.

On-line Advertising Services

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

Web Services

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

Television

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

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

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

During 2003, the broadcaster La7 sought to consolidate its editorial image, its brand awareness and its programs. In particular, La7 is now perceived as a high-quality broadcaster and its Auditel audience ratings are now regularly over 2% (1.8% for the same period last year). Over the same period, MTV continued to reign as Italy's premier youth television channel, with increasing revenues (an increase by 25.5% from 51 million in 2002 to 64 million in 2003) and an operating profit, after the operating loss recorded in 2002. Growth in gross advertising sales for television segment (La7 and MTV), increased by approximately 40% compared to 2002.

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In late 2003, LA7 and MTV began digital terrestrial television trials in the main cities in Italy. By March 2004, a total of 4,000 households selected by specialist companies took part in trials. In observance of company plans and in compliance with broadcast industry regulations, Telecom Italia Media Group television stations have taken steps to acquire the frequencies and equipment necessary to establish a digital terrestrial broadcast network in compliance with the requisites needed for authorization to set up a digital terrestrial television operator company.

Office Products and Services and Business Information

Through Gruppo Buffetti S.p.A. (Buffetti), during 2003 Telecom Italia Media was a leading distributor of office products and business solutions in Italy.

Professional Publishing

Through GPP, Telecom Italia Media has interests in companies publishing specialized information in the hotel, restaurant and entertainment industry, in electronics, information technology and audiovisual communication and in ceramics, architecture and urban design sectors.

Table of Contents**Financial data of the main subsidiaries**

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

		Parent Company		National Subsidiaries		
		Telecom Italia Media		Matrix	Media and Comunicazione Group	Buffetti Group
(millions of Euro)		Historical(1)	Pro Forma(1)			
Gross operating revenues	2003	743	223	36	113	156
	2002	1,152 (35.5)	115 94.1	28 28.2	88 27.8	171 (8.8)
	Change (%)					
Gross operating profit	2003	300	20	3	(29)	8
	2002	545 (45.0)	3	(7)	(45) 36.2	10 (17.3)
	Change (%)					
Operating income	2003	158	(25)	(5)	(51)	2
	2002	348 (54.7)	(51) 51.0	(15) 68.2	(64) 20.3	4 (63.8)
	Change (%)					

(1) In order to allow a better understanding of the results of the business managed by Telecom Italia Media after the SEAT Spin-off, the figures are presented on an historical and pro forma basis.

Major 2003 corporate events/scope of consolidation

On May 9, 2003, the SEAT extraordinary shareholders meeting approved the proposed proportional spin-off of substantially all of the Directories, Directory Assistance and Business Information business segments of SEAT into New SEAT. The spin-off became effective on August 1, 2003. On the same date, the corporate name of old SEAT became Telecom Italia Media S.p.A. . The shares of both companies are listed on the automated screen-based trading system (Mercato Telematico Azionario) of Borsa Italiana. For a further description of these businesses and of the reasons for the spin-off, please see Business Significant Developments during 2003 SEAT Spin-off and Sale .

Events subsequent to December 31, 2003

Sale of CIPI s stake by Telecom Italia Media

On January 29, 2004, Telecom Italia Media sold, as part of the rationalization of its portfolio of activities, its 60% stake in CIPI S.p.A. to Promoinvestments S.r.l., a company owned by the Circo family, already minority shareholder of CIPI S.p.A.. The value of the transaction amounted to 6.5 million and Telecom Italia Media recorded a capital gain of 4.9 million.

Other agreements

On February 3, 2004, the City of Pesaro and La7 Televisioni S.p.A. a company controlled by Telecom Italia Media which operates the La7 TV station signed a memorandum of understanding for the experimentation of land-based digital television (DDT) directed to the development and broadcasting of publicly useful interactive services for the city of Pesaro. The experiment, which involves 100 families, will bring the city s interactive services into the homes of its citizens and will be able to be accessed simply by using the TV remote control.

On February 11, 2004, Telecom Italia Media, Sun Microsystems Italia, a leader in network systems, and CSP Innovation a leader in information communications technology, signed an agreement for the experimentation of innovative services for land-based digital television in the province of Turin.

Agreement for the sale of GPP

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

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

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

Information Technology Market

The Information Technology Market Business Unit (IT Market) was created in early 2002 with the aim of focusing the activities previously concentrated in the Information Technology Services Business Unit by type of customer.

The IT Market Business Unit is a full Business Solution Provider for government, banks and enterprise providing consultancy services, system integration, CRM and ERP solutions and web services. Increasingly the IT Market Business Unit is developing technological and commercial partnerships with the leading providers of information technology products and solutions worldwide (Microsoft, Oracle, Sap, FileNET, Siebel).

As of December 31, 2003, IT Market was organized as follows:

Information Technology Market

Finsiel Group:

Finsiel S.p.A.

Banksiel S.p.A.

Insiel S.p.A.

Tele Sistemi Ferroviari S.p.A.

Webegg Group:

Webegg S.p.A.

Software Factory S.p.A.

Teleap S.p.A.

Eustema S.p.A.

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Due to the macro-economic situation, as in 2002, 2003 was marked by continuing weak demand for IT services, with the consequential pressure on pricing for top customers, as well as the acquisition of new orders and new customers at lower prices than in the past. In response to the weak market conditions, action was taken to further improve overall efficiency and to reduce costs, particularly with reference to Finsiel S.p.A. and the major subsidiaries.

Main Subsidiaries

Finsiel Group

The Finsiel group, which covers the whole chain of value of Information Communication Technology or ICT services, is the second-largest Italian supplier of IT solutions and services, and leads the ICT market in the Public Administration sector, with customers in the most important state administrations and in more than 1,000 local governmental organizations and health agencies.

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

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

Table of Contents**Webegg Group**

The Webegg group is a multi-functional group with a network of international partners, the corporate purpose of which is to position companies on-line. It operates mainly through the company Telemedia Applicazioni S.p.A., which supplies CRM systems, particularly for Telecom Italia Mobile and for third-party customers, while Software Factory S.p.A. concentrates on developing software exclusively for the banking and insurance sectors. See Events subsequent to December 31, 2003 .

Financial data of the main subsidiaries

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

<u>(millions of Euro)</u>		<u>Finsiel group(*)</u>	<u>Webegg group(*)</u>
Gross operating revenues	2003	777	75
	2002	661	80
	Change (%)	17.5	(6.3)
		_____	_____
Gross operating profit	2003	72	10
	2002	73	8
	Change (%)	(1.4)	25.0
		_____	_____
Operating income	2003	54	5
	2002	35	2
	Change (%)	54.3	150.0
		_____	_____

(*) The 2002 financial data are consistent with the 2003 scope of consolidation.

Major 2003 corporate events/scope of consolidation

During 2003, the main IT Market Business Unit corporate events and changes in the scope of consolidation are the following:

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- on January 1, 2003, the Netikos Group (which includes Netikos S.p.A. and Netikos Finland Oy), the Webegg Group (which includes Webegg S.p.A., Domus Academy S.p.A., @Live S.p.A., Winner Project B.V., Software Factory S.p.A. and Telemidia Applicazioni S.p.A.) and Eustema S.p.A. were transferred from the IT Group to the scope of consolidation of the ITM Business Unit.
- On July 23, 2003, (with effects since July 1, 2003), IT Telecom S.p.A., 100% shareholder of Netikos S.p.A., sold the Netikos Group to MyQube S.A. for a sale price of 2 million. As result of this transaction, the 2003 statement of operations includes Netikos only for the first six months.
- On July 31, 2003, Webegg and Telecom Italia signed an agreement for the sale of the 67.33% stake in Domus Academy S.p.A., (with effects since July 1, 2003). As result of this transaction, the 2003 statement of operations includes Domus Academy S.p.A. only for the first six months.
- On July 31, 2003, an agreement between Finsiel S.p.A. and Sogei S.p.A. for the sale of 49% Finsiel share in Sogei IT S.p.A. was signed. On October 9, 2003, after authorization was received from the Antitrust Authority, Finsiel sold its investment in Sogei IT to Sogei, consisting of 25,480 ordinary shares, equal to 49% of share capital, at the price of 1.6 million.
- In October 2003, the extraordinary shareholders meetings of Finsiel S.p.A. and Eis S.p.A. (100%-owned by Finsiel) resolved to merge Eis S.p.A. into Finsiel S.p.A. (with effect from January 1, 2003).
- On November 3, 2003, a preliminary contract for the sale of 22.5% Finsiel stake in Praxis Calcolo S.p.A. was signed. The transaction became effective on November 28, 2003.
- On December 23, 2003, the extraordinary shareholders meeting of @Live S.r.l. resolved to wind up and liquidate the company with effect from December 31, 2003.
- In December 2003, Simest S.p.A. sold its 7.44% share in Finsiel Romania to Finsiel S.p.A.. As a result of this operation, Finsiel S.p.A. currently holds 97.97% of Finsiel Romania.

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The following transactions also took place in 2003:

- On October 1, 2003, the Enterprise business area (responsible for planning, implementing and selling IT solutions on the Enterprise Market, and managing applications and facilities on this same market) was transferred from Finsiel to IT Telecom.
- On October 1, 2003, the Administrative Services Center business area was transferred from Finsiel to Telecom Italia.
- On October 1, 2003, the Desk Top Management business area (operating in distributed workstation management, technical support and hardware maintenance) was transferred from Finsiel and Banksiel to Hewlett Packard.
- On November 1, 2003, the PAL Bologna business area (responsible for UBC service management the Unified Booking Center for the Bologna Metropolitan area, offering applications advice, corrective maintenance and software upgrades, hardware support and peripheral systems management, helpdesk and second level care) was transferred from Finsiel to Webred.

Events subsequent to December 31, 2003

Sale of the Facility Management

On January 1, 2004, the Facility Management of Finsiel S.p.A. was transferred to Emsa Servizi S.p.A..

Information Technology Group

The Information Technology Group (IT Group) Operating Activity is responsible for the information technology activities of the Telecom Italia Group and covers the entire range of information services.

As of December 31, 2003, the IT Group included the following companies:

Information Technology

Group

IT Telecom Group

IT Telecom S.p.A.

Teco Soft Argentina S.A.

EPIClink S.p.A.

As of December 31, 2003, the IT Group was organized as follows:

The Operating Activity is organized into five production divisions:

- **IT Architectures** design and creation of applications and infrastructure architectures, ensuring rationalization and standardization;
- **IT Operations & Infrastructures** design and management of the IT infrastructures required for the functioning of Telecom Italia Group systems and applications and the delivery of investment-based services for the market; the running of IT systems and solutions;
- **Business Support System** - design and development, for the business segment, of the IT systems, solutions and applications for the Business Units of the Telecom Italia Group;

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- **OSS & VAS Solutions** design, development and maintenance, for the network segment, of the IT systems, solutions and applications for the Business Units of the Group; development and system integration of hi-tech IT solutions with high added value, supplying technological support to the Business Units of the Telecom Italia Group in the development of innovative services;
- **Operational Planning & Client Management** coordination and support for the operative functions responsible for planning, staffing, operational control and the monitoring of the main projects; preparation of the systems plan.

In the year 2003, the organization and standardization activities have continued to improve the Group architectural and infrastructure solutions. Such activities were focused on important investment projects such as Business Continuity, Disaster Recovery, Griffon, Data Center Consolidation (Reduction), and also on the convergence and innovation of our IT infrastructures.

Among the main activities in the BSS (Business Support System) area, new projects were begun with the aim of providing Wireline with better tools for business management and replace legacy platforms with new CRM (Customer Relation Manager) platforms, a new platform for credit management and a new platform for acquisition and management of traffic (the completion of the latter is due for June 2004).

In addition, the activities with TIM have continued, particularly with CRM, Charging and Billing, Prepaid and Business Intelligence projects. Also in the OSS area, innovation has continued, while replacing the former legacy environments.

Within the Service Assurance Process the integration of Trouble Ticket Management/Work Force Management systems was started to support claims and trouble management.

Within the Service Provisioning Process, the UNICA/D module was delivered throughout the Italian territory, with the new release of CPC module (to manage respectively the Network and Service Inventory and the Network Configuration of Broadband Services), and the Order Manager Module which completed phase 2 of the project for the new Broadband Management Platform (NPG-BB). As well as helping to improve the quality of service offered to customers, the new platform has made it possible to eliminate a considerable number of legacy systems.

As for VAS solutions, IT Group has improved its support to develop innovative proposals for Wireline and TIM markets.

Major 2003 corporate events/scope of consolidation

- In January 2003, the merger into IT Telecom of its 100% owned subsidiaries (Netsiel S.p.A., Saritel S.p.A., Sodalìa S.p.A. and Telesoft S.p.A.), became effective. The merger was carried out to obtain more efficiency and effectiveness in the information technology services rendered to the Group and to focus on innovation, services and products.
- Starting from January 1, 2003, Netikos Group, Webegg Group, TILAB, Loquendo and Eustema are not included in the IT Group Operating Activity. TILAB became part of the Other Activities, Loquendo was transferred to the Wireline Business Unit and the other companies were transferred to the IT Market Business Unit. On the same date EPIClink was included in the IT Group Operating Activity.

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- In February 2003, Telecom Italia and Hewlett-Packard reached an agreement in the area of Management Services and Outsourcing with a total value of 225 million. Under the terms of this agreement, HP will supply asset management, help desk, maintenance and workstation management, while IT Telecom will manage Hewlett Packard Italia's operational activities in the SAP environment, housing the systems in its Data Centers. On April 16, 2003, the agreement became effective and, on the same date, a contract for the sale of IT Telecom's Desktop Management services business segment to Hewlett Packard DCS (Distributed Computing Services) was finalized.
- On March 28, 2003, the subsidiary Telesoft Hellas was sold to STET Hellas, with effect from January 1, 2003.
- On June 11, 2003, Sodalìa Inc. was sold to third parties, with effect from June 1, 2003.
- On July 23, 2003, IT Telecom sold its entire holding in Netikos S.p.A. to the Belgian company MyQube S.A. for 2 million. The Netikos group was consolidated in the IT Market Business Unit to

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which it reported functionally. At the same time as the sale, a long-term (2004-2007) commercial agreement was put into place between Telecom Italia, Netikos and MyQube for professional services to be rendered by Netikos to the Telecom Italia Group.

- On July 31, 2003, IT Telecom transferred to Shared Services Center former Pirelli Informatica S.p.A., a software company owned by Pirelli the product division Corporate Solutions (which comprises approximately 270 employees) in exchange for a 45% stake in the capital stock of the company.
- On August 8, 2003, a total of 1,386,455 shares of new SEAT, the company resulting from the proportional partial spin-off of SEAT Pagine Gialle S.p.A., was sold to SILVER S.p.A.. IT Telecom S.p.A. remains the holder of 525,896 shares of the spun-off company which took the name of Telecom Italia Media S.p.A.
- On October 1, 2003, IT Telecom acquired from Finsiel S.p.A. the Enterprise business segment (253 people) specialized in services and platforms related to Vertical Solutions and Enterprise Re-engineering Management.
- On December 1, 2003, pursuant to the Kings project, approved by Telecom Italia, IT Telecom contributed its Facility Management operations (53 people) to Emsa Servizi.

Events subsequent to December 31, 2003

Sale of the Innovative Services Business Segment to TIM

On April 1, 2004, IT Telecom S.p.A. sold its Innovative Services Business Segment to TIM S.p.A.; the activities of this business segment are conducted in the innovative services field, based on IP networks and oriented towards the business and mass-market sectors, and they are also related to the development and maintenance of software for telecommunications. The transfer's value, based on an independent evaluation, was agreed at 23 million. There has been a staff transfer of 551 units.

Sale of equity stake in Webegg S.p.A.

On June 7, 2004, IT Telecom S.p.A. signed an agreement with Value Partners S.p.A. regarding the sale of a 69.8% equity stake in Webegg S.p.A. for a sale price of 43 million. Finsiel will retain the remaining 30.2% equity interest. The deal provides for reciprocal put and call options for Finsiel and Value Partners S.p.A. on the remaining equity interest held by Finsiel. The transaction will be completed on receipt of necessary approvals from the Antitrust Authority.

Olivetti Tecnost

Olivetti Tecnost and its subsidiaries (the Olivetti Tecnost Group) supply office products and digital printing systems through its Office Products Division, specialized applications for service automation in banking, retail, trade industry applications and gaming and lottery management through its Systems Division. In addition, the Olivetti Tecnost Group operates with the Industrial Operations Division in the development and production of silicon technology (including ink-jet print-heads and MEMS), in document management services and in the mobile phone repairs

business.

This Business Unit operates mainly in Europe, Asia and North America.

As of December 31, 2003, the Olivetti Tecnost Business Unit included the following companies:

Olivetti Tecnost Group

Olivetti Tecnost S.p.A.

Olivetti I-Jet S.p.A.

Innovis S.p.A.

Cell-Tel S.p.A.

Wirelab S.p.A.

Olivetti Tecnost International B.V.

(foreign sales companies)

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As of December 31, 2003, the Olivetti Tecnost Group was organized as follows:

Office Products Division The Office Products Division has been repositioning its two business lines: the *Professional Line of Business*, which focuses on digital copiers and printers, with an innovative offer of value-added digital products enhanced by loyalty-boosting services; and the *Ink-Jet Communication & SOHO Line of Business*, which develops products based on ink-jet technology such as fax, printers and multifunctional products, as well as calculators and original supplies.

The Office Products Division targets its offer to the business market. The Office Products Division intends to complement its well-established dealer channel with direct sales operations on key markets and development of correlated services.

Olivetti Tecnost is the leading European vendor of ink-jet fax and supplier to Europe's main telecommunications operators. In addition, it markets ink-jet fax and other products in the SOHO segment through distributors and specialist chain stores.

Systems Division Move to achieve geographical diversification became effective with the acquisition of new orders on foreign markets, particularly in the field of gaming.

Contracts were signed with two lotteries in India, in Tunisia (a pilot test for a game similar to the football pools) and in Peru (football pools) requiring the Systems Division to supply more than 20,000 terminals.

In Italy, during August 2003, the System Division successfully started the Lottomatica network for the new Totocalcio system (football pools) which involved supplying terminals, software and services to adapt the pre-existing collection system.

In the banking sector, there was a generalized recession in the markets of Western countries which slowed down sales and reduced volumes in the first half of the year 2003. Starting from the second half there were signs of a recovery: a significant order was acquired from Abbey-National Bank (UK) to renew its printing equipment (approximately 9,000 printing stations).

Stagnation continued in China, where sales were very low and there was a loss of profit margins as a result of the foreign exchange effect and falling prices. Conversely, there was a significant recovery in other parts of the Asia-Pacific region with increasing volumes.

In the international retail sector, sales (volumes and margins) of the range of PR4 products are in line with forecasts. In Italy, the Shop Automation business of fiscal Cash Registers confirmed the improvement in margins achieved in the first half of 2003. However, announcements about changes to the regulatory framework (the law on the agreement for shop owners) drastically reduced demand in the last part of the year; once the initial uncertainty has passed, there is expected to be a recovery.

South America In 2003, the process to wind-up the companies in the South America Area began.

North and Central America Olivetti Tecnost is present in Mexico and in North America, through the subsidiary Royal Consumer Information Product Inc. under the Royal brand name, focusing on office equipment, accessories and consumer electronic products for the consumer and small business market.

Industrial Operations Industrial re-conversion of the Division continued during the year 2003 with the launch of the company Cell-Tel which operates in the area of mobile phone repairs alongside the company Innovis which is operational in the back-office sector. Furthermore, at the end of July, Wirelab was set up; starting in the third quarter of 2003, the company operates in the sphere of repairing and regenerating fixed telecommunications equipment.

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With reference to Olivetti I-JET, development activities continued on MEMS applications in the sector of pressure sensors for automotive applications, and also in the sector of optical components, where Olivetti I-Jet acts mainly as a silicon foundry. Full-scale production also continued for Olivetti I-JET ink-jet print-heads.

Major 2003 corporate events/scope of consolidation

- On January 7, 2003, the contract signed with SMT Vertronic, a Mexican company in the SMT group, for the sale of the industrial assets of the subsidiary Olivetti Tecnost de Mexico became effective. This agreement led to the sale of the factory in Tlaxcala (Mexico) and the hiring of the employees working in the factory (1,266 at December 31, 2002) by SMT Vertronic.
- On February 13, 2003, the agreement with TEL.I.S. in the new mobile phone repair business by way of the investment of TEL.I.S. in the company Cell-Tel S.p.A. became effective.
- On May 12, 2003, the Plans of Merger were voted for the incorporation of the companies Tecnost Sistemi S.p.A., Technoproduzioni S.p.A. and Oliweb S.p.A. with and into Olivetti Tecnost S.p.A.. The Plans of Merger became effective on August 1, 2003.
- In line with the strategy aimed at divesting non-core businesses, the following companies were sold:
 - on May 29, 2003, the Domustech (now Dedita) business segment operating in the security and home automation business was sold to ABB Sace S.p.A. (ABB group);
 - on June 10, 2003, the Domustech (now Dedita) investment in the Aprimatic group operating in the door-automation sector was sold to the URMET group; and
 - on July 11, 2003, the investment in Gotoweb S.p.A., (a company operating in ASP Internet services for small- and medium-sized companies) was sold to Comdata S.p.A..
- On July 29, 2003, formation of the company Wirelab S.p.A. (70% Olivetti Tecnost, 30% Tellus S.r.l. Urmec group) destined to carry out repairs of wireline telecommunications equipment in the Canavese area.
- On October 20, 2003, under the plan to reorganize and rationalize back-office operations and administrative area services, the Sales Back End business segment of Olivetti Tecnost S.p.A. (consisting of 24 resources) was sold to the Accenture group, with which an outsourcing contract was signed.
- The process for the wind-up of the companies in the South America Area began: the 2003 financial statements take into account the estimated effects of such process.

Events subsequent to December 31, 2003

Sale of the CRM business segment

Effective January 1, 2004, under the plan to reorganize and rationalize help desk and customer care operations, the CRM business segment of Olivetti Tecnost S.p.A. (consisting of 14 employees) was sold to the Comdata group, with which an outsourcing contract was signed.

The winding up of the following companies was also approved in the first few months of 2004:

- Olivetti de Venezuela C.A. (January 30, 2004);
- Olivetti Peruana S.A. (February 20, 2004);
- Diaspron do Brasil S.A. (March 5, 2004);
- Multidata S.A. Eletronica Industria e Comercio (March 5, 2004); and
- Olitecno S.A. de C.V. (February 17, 2004).

Other Telecom Italia Group Activities

Real Estate and General Services

In February 2003, the Real Estate and General Services Operating Activity was disbanded; all real estate activities and general services were reassigned to the Telecom Italia Purchasing Corporate Function, which continued to be an interface for the various corporate Functions/Business Units to satisfy the needs of the real estate and general services area.

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In particular, the activities performed are related to the planning of sites and locations of the Telecom Italia Group, the design and construction of civil works, the maintenance of the properties and technological plants, in addition to providing real estate and general services.

These activities and services were operated through the internal structures of Telecom Italia mainly for the activities conducted on behalf of the Telecom Italia Business Units/Corporate Functions and through the subsidiary Emsa Servizi S.p.A., which, for the most part, geared its activities towards the other companies in the Telecom Italia Group.

In December 2003, the Facility Management business areas of Tim, IT Telecom and Finsiel were transferred to Emsa Servizi S.p.A.: such transactions became effective on December 1, 2003, for Tim and IT Telecom, whereas for Finsiel the transfer became effective on January 1, 2004.

The transfer of such business functions permitted Emsa Servizi to improve the quality of its facility management expertise for the benefit of the other companies in the Telecom Italia Group.

International Affairs (the former Foreign Holdings Corporate Function)

In May 2002, the companies and business segments of the Telecom Italia Group which formerly reported to the International Operations (IOP) Operating Activity were transferred to Domestic Wireline and to Foreign Holdings Corporate Function (now International Affairs), while all the companies based in Latin America were subject to the coordination of LAO.

As of June 18, 2003, the new corporate function, International Affairs, was established and reports directly to the CEO Carlo Buora. On the same date the central function Foreign Holdings was merged into International Affairs.

The corporate function International Affairs guarantees the coordination of the activities managed by Telecom Italia International and ETEC S.A.

During the course of 2003 and the beginning of 2004 the Telecom Italia Group, through Telecom Italia International continued to pursue its targets under the business plan, focusing on reorganizing and rationalizing its international presence. The principal corporate transactions which took place in 2003 were the following:

- On January 20, 2003, Telecom Italia International did not subscribe to the new capital increase in Euskaltel (the regional operator for cable TV and applied telecommunications for the Basque countries) approved by the Shareholders meeting on December 16, 2002. As a consequence, Telecom Italia International's stake fell to 13.85%. On June 12, 2003, the Company entered into an agreement with Bilbao Bizkaia Kutxa (BBK) for the sale of part of its stake in Euskaltel, corresponding to 7.75% of Euskaltel's total share capital. The transaction for a consideration of 34 million, was finalized on October 10, 2003.

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- On December 30, 2003, Telecom Italia International received an offer to sell an additional 3.1% stake in Euskaltel for a total amount of 13.6 million. On January 16, 2004, the sale and purchase agreement between Telecom Italia International and Araba Gertu S.A. was signed. On the same date Telecom Italia International sent a notice to the other shareholders of the company offering them to exercise, proquota, their pre-emptive rights on the same terms and conditions agreed with Araba Gertu S.A.. As of February 16, 2004, the pre-emptive right was exercised only by Iberdrola SA.. Furthermore on February 19, 2004 (the Closing date), two separate deeds of sale were signed: the first between Telecom Italia International and Araba Gertu (149,231 shares for a consideration amount of 12.1 million) and the second between Telecom Italia International N.V. and Iberdrola (18,719 shares for a consideration of 1.5 million). Following such a sale Telecom Italia International's stake in Euskaltel decreased to 3.0%.
- On February 20, 2003, Telecom Italia International executed a Share Purchase Agreement, for the sale of its entire participation in Telekom Srbija, corresponding to 29% of the Telekom Srbija share capital for a total consideration of 195 million. The payment of the first tranche of 120 million was completed in June 2003. The shares remain in an escrow account until full payment of the remaining 75 million is made.
- On July 8, 2003, Telecom Italia International N.V. exercised its put option on all of its Mediterranean Broadband Access (MBA) shares (40%) to Forthnet (parent company of MBA) for a consideration

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equal to 7.04 million which was finalized on October 29, 2003. In parallel, Telecom Italia International, subject to the completion of the sale of MBA's shares as described above on October 29, 2003, subscribed to a reserved capital increase in Forthnet, for a value equal to 7.04 million (corresponding to 7.81% of Forthnet share capital). The Forthnet shares have been listed on the Athens stock exchange.

- In August 2003, Telecom Italia International on the basis of an irrevocable offer, received from Telecom Italia Sparkle, for the purchase of the 100% stake of Intelcom San Marino proceeded to purchase the remaining 30% of the share capital of the subsidiary from third parties for consideration of 4.25 million. The sale of the entire participation of Telecom Italia International in Intelcom San Marino to Telecom Italia Sparkle, was completed as of December 23, 2003 for a consideration of 14.2 million.
- Telecom Italia International, following the agreement reached in June 2002, with OIAG, in the month of November 2002, sold 75,000,000 Telekom Austria shares at a price of 7.45 per share, reducing its investment from 29.78% to 14.78%. Under such agreement, the sale of the remaining part of the shares held by the Telecom Italia Group was permitted from January 1, 2004. Consequently on January 27, 2004 Telecom Italia International sold the remaining 14.78% stake in Telekom Austria for a total gross consideration of 780 million.
- On March 4, 2004, Telecom Italia International signed a Shares Purchase Agreement with AUNA to sell its entire participation in Netco Redes S.A. (30%) for a consideration of 30 million plus interest to be paid in three annual installments starting from December 2006. The closing will take place subject to receiving regulatory approval.

Cuba

On December 16, 2003, the establishing in Cuba of an integrated TLC operator acting both in the wireline and in the mobile sectors was finalized through the incorporation of the local mobile operators Cubacel and C-Com into Empresa Nacional de Telecomunicaciones de Cuba S.A. (ETEC S.A.). Due to the merger, Telecom Italia International's stake in ETEC S.A. was reduced to 27%. The merger resulted from the agreements signed on October 1, 2003, between all shareholders of the relevant entities in order to set-up the integrated TLC operator. These agreements provide amongst others the granting of a new more extended license to the new entity for rendering fixed line and mobile services up to December 31, 2019. In respect of the new license, a total fee of U.S.\$185.18 million payable within one year is to be made by ETEC S.A.. The fee shall be financed by capital increases to be underwritten by each shareholder. Telecom Italia International's share amounts to U.S.\$50 million. The first capital increase of U.S.\$35.9 million was subscribed by Telecom Italia International on December 16, 2003 for a total amount of U.S.\$9.8 million.

On March 4, 2004, the shareholders' meeting of the Cuban company voted a further share capital increase, of U.S.\$23.8 million, through the issue of 165 new shares with a par value U.S.\$144,190 each. Telecom Italia International proportionally subscribed to its share of the capital increase for U.S.\$ 6.3 million in exchange for 44 new shares.

On May 20, 2004, the shareholders' meeting of ETEC S.A. voted a further share capital increase of U.S.\$31,578,000, through the issue of 219 new shares with a par value of U.S.\$144,190 each. Telecom Italia International proportionally subscribed to its share of the capital increase of U.S.\$8.5 million in exchange for 59 new shares.

In order to fulfill the long-term objectives related to its license, ETEC S.A. increased during 2003 the number of lines from 646,000 in 2002 to 696,000 (an increase of 8%), while the digitalization rate rose to 81.6% from 76% reached in 2002. As a consequence of the merger, ETEC S.A. acquired 43,987 mobile customers. In 2003, ETEC S.A. has maintained the focus on Internet and data transmission commercial development, achieving a 13% growth against 2002 (from approximately U.S.\$13.4 million in 2002 to U.S.\$15.2 million in 2003). In 2003, total operating revenues, excluding the three months effect of the mobile contribution (U.S.\$13.7), were U.S.\$310 million compared with U.S.\$294 million in

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2002, an increase of 5.4%. Gross Operating profit increased from U.S.\$202 million in 2002 to U.S.\$209 million in 2003 (an increase of 3.5%) and operating income was U.S.\$141 million compared with U.S.\$139 million in 2002 (an increase of 1.4%). Net income was U.S.\$133 million in 2003 compared to U.S.\$132 million in 2002 (an increase of 0.8%).

Brazil

Telecom Italia International also has an indirect participation in Brasil Telecom which is currently only in the fixed line business although Brasil Telecom is seeking to enter the mobile business. In 2002, Telecom Italia

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International reduced its ordinary share ownership in Solpart, controlling entity of Brasil Telecom, so TIM could begin its own mobile operations in Brazil under its GSM licenses acquired in 2001. There is currently a dispute over Telecom Italia International regaining its rights in Brasil Telecom. See Item 8. Financial Information Legal Proceedings . As a result of the overlapping interests of Brasil Telecom and TIM in providing mobile services, the order of the Brazilian Telecommunications Agency, Anatel, dated January 19, 2004, requires the parties to resolve by mutual agreement any such overlap . We believe any such resolution is unlikely to have any material adverse impact on TIM s GSM services in Brazil.

Telecom Italia Lab

The Telecom Italia Lab Operating Activity (TILAB) is responsible for supervising technological innovation within the Telecom Italia Group, in the sector of networks and innovative services. As a result, the activity of TILAB is chiefly oriented towards providing support to the Business Units of the Telecom Italia Group by offering competitive technology and, at the same time, pursuing the objective of improving quality and efficiency and promoting innovation.

As of December 31, 2003, the Operating Activity was organized as follows:

TILAB

Telecom Italia TILab segment

Telsy S.p.A.

The Operating Activity was managed with the following organization:

Innovation Delivery is focused on short-term goal-oriented research activities geared essentially to the Business Units of the Telecom Italia Group.

Service Innovation and Network Innovation are devoted to medium and long-term research projects with a focus on infrastructures and on the creation of services and the testing of prototypes through innovative platforms, in order to create competitive advantages for the Business Units of the Group.

Telsy, since 1971, has been the leading supplier of information security solutions to the Group, offering off the shelf and customized encryption equipment.

TILAB performs both strategic research and research specifically requested by Group Companies that focuses on projects that are of strategic interest for the individual Business Units and advances the Group s technological leadership. Research is also carried out in specific areas in

partnership with Pirelli Labs.

The activities are organized into the main innovative areas of interest to the Group such as:

- Terminal and user interfaces,
- Applications and Services,
- Service control,
- Access, metro and core network, and
- Network operations and management.

Increasing attention to the opportunity of generating competitive advantages and creating value for the Telecom Italia Group was also pursued through the strategic management of the relations between research, Intellectual Property Rights (IPR) and business with the aim of increasing the number of registered patents. In this context, during the year, 68 new patents were filed of which 14 are jointly owned with Pirelli.

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- *development of the MAS (Metro Access System) network element based on CWDM (Coarse Wavelength Division Multiplexing) technology, equipped with its element manager system EMMAS (Element Manager Metro Access System).* This activity is related to the network and services management area for metropolitan applications;
- *first live call on TIM UMTS network over RoF (Radio over Fiber) links.* As a result of RoF technology, 3G radio access networks will be realized in urban areas for optimizing radio access capacity. The first RoF modules were provided to Alcatel.

Major 2003 corporate events/scope of consolidation

- Merger by incorporation of the subsidiary Telecom Italia Lab S.p.A. into Telecom Italia S.p.A., agreed on March 18, 2003, effective for accounting and tax purposes as from January 1, 2003.
- The transfer of Loquendo S.p.A., previously included in TILAB, into the Wireline Business Unit.
- Transfer of TILAB's Venture Capital activities to Telecom Italia Merger & Acquisitions Corporate Function (now Corporate Development and Investor Relations).

Other Subsidiaries

Telecom Italia Finance S.A.

Telecom Italia Finance S.A. (TI Finance) organized in the Grand-Duchy of Luxembourg as a Société Anonyme, is a 99% owned subsidiary of Telecom Italia. TI Finance provides financial assistance to Telecom Italia as well as companies in which Telecom Italia has a direct or indirect interest such as, among others, providing loans and the granting of guarantees for securities of any kind or form. TI Finance also may borrow in any kind or form and issue bonds or notes.

TI Finance had net income of 333 million for 2003 and a net equity as of December 31, 2003, of 256 million. The results for 2003 are primarily due to the sale of a portion of fixed-rate bonds which were issued by Telecom Italia in 2001 as private placements. With the proceeds of such sale, TI Finance granted several loans to Telecom Italia based on the then applicable market conditions. The sale of the bonds generated a gain of 396 million which is and will be compensated by lower financial revenues up to the end of 2005. On February 20, 2004, Olivetti International S.A. (a 99% Luxembourg-based Telecom Italia subsidiary) was merged into TI Finance. As a consequence of the merger, TI Finance issued 30,000,000 new ordinary shares and the current share paid up capital of TI Finance amounts to 1,162,562,614.74, divided into 118,871,433 shares of 9.78 per share.

Telecom Italia Capital S.A.

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The company is a directly and indirectly wholly-owned subsidiary of Telecom Italia, organized under the laws of Luxembourg, and was established in the year 2000 as the finance vehicle to issue notes in the U.S. market. On October 29, 2003, Telecom Italia Capital issued fixed-rate multi-tranche notes in U.S.\$ with a full and unconditional guarantee of Telecom Italia. Details are as follows:

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

Subsequently, Telecom Italia Capital granted a loan for the same amount of the notes to Telecom Italia.

Saiat S.p.A.

The company, held 100% by Telecom Italia, carries out support services for the Telecom Italia Group, in some finance activities. In particular during 2003, the company continued to provide services under the program for the securitization of the Telecom Italia Group trade accounts receivable.

TI Learning Services S.p.A.

This company operates in the Training sector with the objective of achieving a significant market share in the learning and knowledge management markets.

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The Company designs complex and customized training systems that can be used by large numbers of people. Its product range includes more than 2,200 courses for training developed by e.learning as well as in the class room, particularly on topics associated with ICT and Business Management.

The above activity is mainly provided to the Telecom Italia Group.

During the year 2003, TI Learning Services S.p.A., supported by the Board of Directors of Telecom Italia, began a restructuring of its activities. The main guide lines are: head count reduction in order to reduce costs and to introduce a change in management.

Other Investments

Multimedia Services

Stream (now SKY Italia) was formed in 1993 by Telecom Italia with the objective of establishing and promoting a wide range of multimedia services and applications for the Italian and other international markets. Subsequently, Stream focused its activity on the Italian pay television market.

After some changes in the shareholding structure, by the end of 2001 Stream was equally owned by Telecom Italia and News Corporation. On October 1, 2002, Telecom Italia signed an agreement with the News Corporation Group, partner of Telecom Italia in Stream, and Vivendi Universal, shareholder of Tele+ (Stream's main competitor), in order to allow Stream to purchase Tele+ and to subsequently create a single Italian pay-TV company on one platform.

On April 30, 2003, the agreement announced on October 1, 2002 was finalized between Telecom Italia and News Corporation for the creation of Sky Italia, a company that came into being as a result of the merger between Stream and Tele+.

Following this transaction, Telecom Italia sold a 30.1% stake in Stream: 25% to News Publishing Australia Limited and 5.1% to SGH STREAM SUB, Inc.

After this transaction, Telecom Italia holds 19.9% of Sky Italia; the remaining 80.1% is held by News Corporation.

Competition

Fixed-line Domestic and International Telecommunications Services

Pursuant to the telecommunications regulations approved by Presidential Decree No. 318 of September 19, 1997, which became effective on October 7, 1997 (the Telecommunications Regulations), fixed-line public voice telephony services and the operation of the fixed-line network for the provision of such services was liberalized effective January 1, 1998. Until January 1, 1998, the Telecom Italia Group was the sole provider of fixed-line public voice telephony services, which consist of local, long distance and international telecommunications services, in Italy. In addition to fixed-line public voice telephony services, over the last six years there has been increasing liberalization of all other business areas in which the Telecom Italia Group operates. The operation of telecommunications infrastructure for the provision of all telecommunications services other than fixed-line public voice telephony services was opened to competition by the Telecommunications Regulations and Law No. 249 of July 31, 1997 (the Maccanico Law), during 1997. As a result of the complete liberalization of the market for telecommunications services, the Telecom Italia Group has faced increasingly significant competition since 1998 in the Italian domestic market, including competition from foreign telecommunications operators, particularly with respect to medium-sized and large business customers.

The legal framework for regulation in the telecommunications sector in Italy was completely transformed, as a consequence of the adoption of the Maccanico Law (effective August 1, 1997), the Presidential Decree No 318/97 (the Telecommunications Act) (effective September 22, 1997) and a series of Orders issued by the National Regulatory Authority which have been important to the Telecom Italia Group as it has faced increasing competition. To date the regulatory environment has been characterized by an intensive implementation process in order to complete liberalization. The trend continued in 2003 as additional steps were taken regarding tariff rebalancing, interconnection charges and the further signing of contracts to permit the unbundling of the local loop. See Regulation .

Since the beginning of 1997 about 170 licenses have been activated in Italy, although at the end of 2003 only 17

OLOs were still actively competing and offering telecommunication services, as the others failed or were involved

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in merger and acquisition operations. Wireline in its domestic market faces, among others, two national players, Tele2 and Wind, and three other focused competitors: Fastweb (focused on broadband and specific cities), Albacom (focused on business customers) and Tiscali (focused on internet). Only two of these competitors have their own network facilities, Fastweb and Albacom, while the others implement a reseller model utilizing Telecom Italia's network.

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

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

In this competitive environment during 2003 Wireline increased revenues and improved profitability as a result of:

- The increase of its market share on traffic both on Voice-Online (an increase of 0.6% compared to December 31, 2002) and Voice (an increase of 0.5% compared to December 31, 2002), due to the stabilization of its subscriber lines volume, as the unbundling of the local loop has not yet had a material impact, and the successful performance of its winback and loyalty campaign with more than 1.8 million customers acquired and retained from competitors and more than 5.5 million loyalty packages subscribed (21% of total customer base).
- The strong growth achieved in Broadband with 2,200,000 access lines at the end of 2003, of which 160,000 abroad, 1,350,000 more access lines than at the end of 2002.
- The result achieved on Innovative Data Transmission (+42% compared to the end of 2002) and Value Added Services on Data (+30% compared to the end of 2002).

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

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

Mobile Telecommunications Services

The Italian Mobile Market. The mobile telephone market continued to grow in Italy in 2003, but at a slower pace (3.6% in 2003 compared to 7% in 2002 and 21% in 2001). By December 31, 2003, the number of cellular phone lines reached 56.8 million, corresponding to a penetration rate of around 99% of the population.

After several years of strong growth, the demand growth curve has reached its inflexion point and the remaining potential market will be smaller than the one already acquired. In addition, the increasing saturation means that new customers to be acquired are likely to result in lower revenues per customer as has been the case in recent years. Competition for mobile telecommunications services remained strong in 2003. Consequently TIM's strategy has been focused on strengthening its leadership with customers with a high mobile phone usage. TIM's strategy to attract and retain such customers has been to:

- offer innovative tariff schemes and services;
- focus on customer care and service for these valuable customers;
- quality performance;
- reinforce the core voice business; and
- market value added services, such as photomessaging, videos and down loads.

TIM has also sought to be the market leader in providing EDGE and third generation services.

There are three principal competitors to TIM in the Italian mobile market: Vodafone Omnitel, Wind and H3G(3). At December 31, 2003 TIM remained the market leader with a market share of approximately 46% with

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Vodafone Omnitel, Wind and H3G(3) having market shares of 36.3%, 17.2% and 0.6%, respectively. In 2003, TIM had a 27.3% market share of net additional GSM lines, corresponding to 0.8 million of net lines, compared to 1.6 million for Vodafone Omnitel, 1.2 million for Wind and the remaining 0.4 million attributable to H3G (3).

TIM's statistical data excludes 700,000 silent lines. The Italian market, which has a high penetration of prepaid cards, is characterized by certain customers acquiring multiple lines in order to take advantage of specific/time-limited commercial offers. Once these offers expire these customers tend not to continue the use of such lines which is facilitated by the prepaid nature of the arrangement. As a result, TIM excludes the silent lines in order to provide greater consistency between the number of lines managed by the Company and the development of the business.

TIM's second largest market is now Brazil where it is focusing increasing capital expenditures and expects to invest around 2 billion over the next three years. There is significant competition in Brazil from a number of local and international operators, the most significant of which are Vivo (a Brazilian company owned by Telefonica) and Claro (a company owned by the Mexican group America Movil). TIM expects competition to increase in the future with continued consolidation in the market.

The Regulatory Framework

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

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

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

This means the mobile sector is one of the segments with the highest potential growth rates and profitability. Technological developments and data transmission will generate new business models based on the capability of offering information, entertainment and advertising through mobile phones and of executing an increasing number of commercial and banking transactions.

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

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

EDGE which at present involves only upgrading the GSM/GPRS software and which is complementary to UMTS will permit TIM customers to have prompt access to the main third generation services. The EDGE launch will bring an important competitive advantage for TIM. TIM will be able to offer services in Italy with a network speed similar to that of UMTS (200 kbit/s for EDGE vs 384 kbit/s for UMTS). In fact, due to the availability of dual mode terminals (EDGE/UMTS) that will be marketed with the Turbo TIM brand, TIM customers will be able to use the band they need for a specific service regardless of the network they are using.

UMTS will be the natural evolution of EDGE: UMTS was launched in May 2004 for corporate clients and will be launched at Christmas 2004 for the mass market when handsets will be available in volumes and the technology will be more reliable.

TIM is the sole operator with a firm commitment to EDGE in addition to UMTS. Currently, only H3G(3) has provided a complete offer for the UMTS technology, while Vodafone Omnitel, consistently with TIM, expects to fully implement UMTS services during 2004.

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REGULATION

Overview

The legal framework for the regulation of the telecommunications sector in Italy has been extensively revised in the last decade. This revision included the liberalization of all telecommunications services including the provision of fixed-line public voice telephony services and the operation of networks to support the provision of such services, which were opened to competition as of January 1, 1998. Most importantly, the legal framework for regulation of the telecommunications sector in Italy has been completely transformed through the establishment of the National Regulatory Authority, and the adoption of the Telecommunications Regulations by the Italian Government pursuant to Law No. 650 of December 23, 1996 (Law 650), and Law No. 189 of July 1, 1997 (Law 189) to implement a number of EU directives in the telecommunications sector, the general objective of which was to create a framework for a fully competitive telecommunications market. Effective August 1, 1997, the former Ministry of Posts and Telecommunications changed its name to the Ministry of Communications pursuant to the Maccanico Law. The Telecommunications Regulations (Presidential Decree No. 318 of September 19, 1997) became effective on October 7, 1997, and have been implemented by specific regulations. The Framework Law in general aimed at:

- ensuring the improvement of competition and efficiency in the telecommunications sector;
- establishing adequate quality standards;
- ensuring access to telecommunications services in a homogeneous manner throughout Italy;
- defining a clear and transparent tariff system based on the price cap method which, pursuant to the Maccanico Law, applied to the Telecom Italia Group's fixed public voice telephony services for up to two years starting on August 1, 1997. The National Regulatory Authority applied the price cap to Telecom Italia fixed public voice telephony from August 1, 1999 to December 31, 2002; and
- protecting consumers and users' interests.

The Telecommunications Regulations completed the liberalization of the provision of all telecommunications services and the operation of all telecommunications networks in Italy, effective from October 7, 1997, except for the provision of fixed public voice telephony services and the operation of telecommunications networks to support provision of such services, which were liberalized as of January 1, 1998. Restrictions on other operators providing telecommunications services, other than fixed-line public voice telephony services and the operation of telecommunications networks, had been lifted by several previous measures, including the National Telecommunications Plan referred to in a Ministerial Decree of April 6, 1990 (the NT Plan), Law Decree No. 55 of February 11, 1997 (satellite communications) and Law Decree No. 103 of March 17, 1995 (Decree 103) and its implementing decrees and regulations (data communications, voice telecommunications for closed user groups and Value Added Services).

The Telecommunications Regulations included provisions concerning:

- the granting of general authorizations or individual licenses to provide telecommunications services;

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- universal service obligations and the mechanism for funding the net cost of such obligations;
- access deficit contributions;
- special obligations imposed on operators having significant market power, including the determination of interconnection charges using principles of cost orientation;
- numbering, carrier selection and number portability;
- rights of way; and
- the essential requirements that must be complied with in the provision of services and when interconnecting with public telecommunications networks.

The National Regulatory Authority has established detailed regulations governing the telecommunications sector and has monitored their application, while the Ministry of Communications has retained the responsibility for defining telecommunications policy in Italy. See The Telecommunications Regulations and Implementing Regulations .

The activities of Telecom Italia and TIM were subject to the terms and conditions of their public operating concessions (the Public Concessions) which were the basis under which telecommunication services were

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provided by Telecom Italia and TIM prior to adoption of the Telecommunications Regulations. The Public Concessions were expected to be made consistent with the new regulatory framework by January 1, 1999, as required by the Telecommunications Regulations but the National Regulatory Authority only started the procedures to achieve such amendments at the end of December 1999. See Public Concessions .

Since January 2001, Telecom Italia has been operating pursuant to a license (Order No. 820/00/Cons). See The Telecommunications Regulations and Implementing Regulations .

Other significant telecommunications measures include Ministry of Communications decrees, Presidential decrees and other regulations as well as orders of the National Regulatory Authority issued since its formation.

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

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

The main characteristics of the Code are as follows:

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

Moreover, the Directives (and other EU-related regulatory interpretations and recommendations) as implemented by the Code provide for guidelines on market analysis and calculation of significant market power and identify 18 markets at retail and wholesale level where such analyses and identification shall be conducted. According to the Code, the Italian National Regulatory Authority will have to conduct a new

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evaluation of the operators having significant market power and propose applicable remedies. Within the authority allowed by EU law, the Code also provides for the following:

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

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

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The National Regulatory Authority (AGCOM)

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

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

The Committee for Products and Services is responsible for, among other things, regulating product quality and conformity with EU directives governing the relationship between companies controlling fixed or mobile telecommunications networks and telecommunications service providers.

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

The National Regulatory Authority is responsible for:

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

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

The National Regulatory Authority has been operational since June 1998.

The National Regulatory Authority has investigative powers, as well as the authority to impose sanctions on operators who do not comply with their directives and resolutions. In addition, the National Regulatory Authority is entitled to propose to the Ministry of Communications the revocation and/or suspension of general authorizations and individual licenses in the event of repeated violations by the holder. The Maccanico Law also permits the National Regulatory Authority to limit access to networks for security reasons.

The Code and Implementing Regulations

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

- universal service obligations;
- obligations imposed on operators having significant market power, in particular with respect to interconnection agreements and accounting policies;
- numbering (carrier selection, preselection, and number portability);

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- rights of way;
- authorizations; and
- introduction of new broadband services.

Universal Service Obligations

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

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

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

In connection with the net cost for the year 2000 submitted by Telecom Italia, the National Regulatory Authority recognized a net cost of 58.9 million, of which Telecom Italia contributes 48.3%. OLOs obliged to contribute to finance such net cost are: TIM (31.4%); Omnitel (18.9%), and Infostrada (1.4%).

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

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

intervene again during 2004 in order to definitively assess the matter.

Decision from the Court on costs of 2000 is still pending.

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

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

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

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As far as 2002 is concerned, the National Regulatory Authority is evaluating the net cost presented by Telecom Italia of 158 million. A final decision should be issued by June 2004.

Special Status of Operators Having Significant Market Power

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

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

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

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

With order 197/99 the National Regulatory Authority in September 1999 also determined that TIM and Omnitel had Significant Market Power for mobile telecommunications services and for domestic interconnections. The National Regulatory Authority reviews and evaluates Significant Market Power operators every year. In 2001, the National Regulatory Authority started a market analysis to identify the operators with Significant Market Power in the year 2000. In addition, on August 7, 2002, the National Regulatory Authority started a procedure to identify telecommunications organizations with Significant Market Power for 2001.

The National Regulatory Authority concluded its inquiry with the aim of identifying the operators with Significant Market Power in the Internet access market (Resolution No. 219/02/CONS sent to Telecom Italia on July 31, 2002) and the SMP 2000 inquiry (Resolution No. 350/02/CONS).

Significant Market Power Internet

In its approval of the measure granting equal status to ISPs and OLOs (Law No. 59/2002), the Parliament ruled that, within two months of the law coming into effect (by June 26, 2002), the National Regulatory Authority would update the list of operators with Significant Market Power in the Internet access market.

In Resolution No. 132/02/CONS of April 24, 2002, the National Regulatory Authority commenced the inquiry by conducting a public consultation with the aim of Updating the list of operators with significant market power on the Internet access market [...] which concluded with Resolution No. 219/02/CONS. This Resolution identified Telecom Italia and Wind as operators with Significant Market Power in the market of calls terminating on the Internet using dial-up technology, and also identified Telecom Italia alone in the final market of switched Internet access services from the fixed network. The Resolution, which became effective immediately, referred to Presidential Decree No. 318/97 for the remedies (publication of interconnection price lists, separate accounting, cost orientation, etc.) which the two operators are bound to respect.

Significant Market Power 2000

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

- 1) Telecom Italia in the markets of public fixed telephone networks and services, leased line systems, and the national interconnection market;

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2) TIM in the markets of public mobile and national interconnection communications systems (termination);

3) Vodafone Omnitel in the markets of public mobile and national interconnection communications systems (termination).

As far as the named operators are concerned, this special status automatically imposed a series of extra legal obligations over and above those which all telecommunications operators are normally expected to fulfill: cost orientation of interconnection prices (and also of retail/leased lines for Telecom Italia), transparency, non-discrimination, and, only for Telecom Italia, separate accounting.

Telecom Italia was designated as an operator with Significant Market Power in the interconnection market, despite having reduced its market share in 2000 to approximately 11% (based on revenues).

Significant Market Power 2001

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

Under the new European regulatory framework, the National Regulatory Authority is in charge of carrying out market analyses. In order to do this, the National Regulatory Authority separated the most important markets according to current laws (Presidential Decree No. 318/97 and Law No. 59/02) into the 18 markets identified by the recommendation of the European Commission, and has entrusted a large part of the above-mentioned analyses to external consultants.

During 2003, the National Regulatory Authority should have conducted the market analyses in order to propose applicable remedies by means of public consultation. However, the National Regulatory Authority only stated the criteria for conducting the market analyses. As the National Regulatory Authority has not yet conducted the market analysis in the identified markets to determine significant market power it is not possible for Telecom Italia to determine the overall impact on its business of the new regulatory regime.

Finally, on March 20, 2002, the National Regulatory Authority began an inquiry into Enel/Wind to verify whether, according to Article 9, sub-section 2 of Presidential Decree No. 318/97, it is necessary to adopt separate accounting directives with regard to Wind, and to impose restrictions ex ante regarding the use of infrastructures associated with special and exclusive rights, including access to information about the users of electricity.

Interconnection

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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 communicate copies of their interconnection agreements to the National Regulatory Authority. Public fixed network operators and leased line service providers having Significant Market Power are required to publish a Reference Interconnection Offer (RIO).

On April 18, 2002, Telecom Italia published the RIO 2002 for Interconnection and Unbundling 2002. The offer was successively integrated with Partial Circuits and FRIACO services (April 30, 2002), with PVC (Permanent Virtual Channel) ADSL and HDSL services (June 14, 2002), and with billing services (July 4, 2002).

With Order No. 2/03/CIR of February 27, 2003, the National Regulatory Authority asked Telecom Italia to integrate the RIO with other services (e.g. interconnection links at 34 and 155 mbps rates) and to modify the economic conditions of traffic conveyance services (origination, termination and transit) and other services such as number portability and Partial Circuits. Consequently, Telecom Italia published a new RIO 2002 on March 27, 2003.

On the same date of Order No. 2/03/CIR, the National Regulatory Authority published Order No. 3/03/CIR, which (on the basis of the previous Order No. 152/02/CONS) introduces a network cap, a mechanism for defining in advance the rules for pricing RIO services according to the RPI (Retail Price Index) and productivity

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factors. The network cap applies for the period 2003-2006. Order No. 152/02/CONS also established non discrimination criteria in interconnection and wholesale market between Telecom Italia and the other licensed operators:

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

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

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

Local Loop Unbundling

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

Telecom Italia appealed this Order to the Regional Administrative Court (TAR Lazio), in particular with respect to the inclusion of fiber optic in the mandatory offer and the costing criteria. On May 12, 2000, Telecom Italia put forward a Reference Offer for Local Loop Unbundling, for approval by the National Regulatory Authority. The National Regulatory Authority finally issued Orders 13/00/CIR and 14/00/CIR, respectively on December 30, 2000 and in January 2001. The former regards the technical and procedural aspects of the provisioning of local loop unbundling and co-location. The latter sets the rates for the unbundled services.

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

During 2001, in line with the suggestions made by the National Regulatory Authority, special areas were made available in exchanges to accommodate other operators with the aim of unbundling local loops. By December 31, 2001 Telecom Italia handed over equipped technological areas to operators in 748 exchanges. In addition, following Resolution No. 24/01/CIR, on December 12, 2001, Telecom Italia presented its rate plan to the National Regulatory Authority for shared access and sub loop (shared access to the local network and access to line

boxes).

On April 18, 2002, Telecom Italia published the Reference Offer of Local Loop Unbundling for 2002, with price reductions for copper pair. On March 2002, around 17,400 unbundled lines were in place, 27 licensed operators requested co-location, 1,043 local switches for co-location were requested by licensed operators and 919 sites were ready for co-location.

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

- shared access: the monthly subscription rate was reduced from euro 4.34 to euro 2.80; the activation charge was reduced from euro 94.36 to euro 81.00;
- full unbundling: the monthly subscription rate for the ADSL pair was reduced from euro 12.60 to euro 11.10;
- the fee for qualification of the ADSL pair was reduced from euro 39.51 to euro 10.37.

On February 27, 2003, with Order No. 2/03/CIR, the National Regulatory Authority approved Telecom Italia's Reference Offer for 2002 (RIO 2002), after hearing the opinions expressed by the Antitrust Authority and

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the European Commission, and after Telecom Italia's submission to the National Regulatory Authority of its regulatory accounting for 2001, which took place on December 20, 2002. The RIO 2002 applied to other local operators for the use of Telecom Italia's network, and provided criteria for changing the charges of the RIO 2002 starting in 2003 for the next four years (the so-called network cap).

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

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

Due to the delay in fixing the cap for the LLU service by the National Regulatory Authority, Telecom Italia published the RIO 2004 on October 31, 2003, maintaining the same level of price for LLU service (8.30/month) as the RO 2003 (even though the incumbent Danish operator price for LLU has now increased to 8.60).

Leased lines

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

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

Mobile termination rate

According to the GSM Concessions (as defined below) of December 1994, mobile network operators were responsible for fixing tariffs for calls originated on the fixed network and terminated on mobile networks. Such regulatory framework has been modified by DPR 318/97 establishing, as a new principle, that the originating operator is responsible for fixing the retail tariff. This principle has been reaffirmed by the National Regulatory Authority with Order No. 85/98. Since issuing this order the National Regulatory Authority has started an assessment of termination rates charged by mobile network operators and with Order No. 338/99 it set 19.0 eurocents/min, the maximum average termination price. The National Regulatory Authority has deemed it necessary to issue new regulations and on February 5, 2003, issued Order No. 47/03 setting new maximum values for the termination rates applied by mobile operators (TIM and Vodafone Omnitel) for calls originated on third fixed networks. The ceilings for mobile termination charges have been established at 14.95 eurocents/min, as from June 1, 2003. For 2004 and 2005 the National Regulatory Authority has envisaged a mechanism (so called network cap) for the planned reduction of termination costs of fixed-mobile which would be introduced along with the improvements and fine-tuning of the regulatory accounting system based on incremental costs and the

review of the obligations following the implementation of the new European regulatory framework. The National Regulatory Authority believes that, within this framework, a planned reduction of a maximum of 10% per year minus inflation in 2004/2005 would be reasonable; no decision has been taken yet.

Accounting Policies

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

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

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

On June 17, 2002, the National Regulatory Authority issued Order 152/02 CONS which requires Telecom Italia to provide more detailed accounting reports on a current cost basis (fully allocated costs); the cost basis previously adopted was the historical one. In compliance with Order No. 152/02 CONS in December 2002, Telecom Italia submitted the Regulatory Accounting Reports for the year 2001 the auditing of which is in progress. During 2001 the National Regulatory Authority issued an order which raised the allowed return on capital employed WACC (weighted average cost of capital) for regulatory purposes from 12.5% to 13.5% before taxes.

TIM cost accounting policy

According to Order No. 197/99 TIM and Vodafone Omnitel have been notified as a Significant Market Power operator in the national interconnection market and must provide a cost oriented fixed-mobile termination rate.

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

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

Numbering

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

Number Portability (NP)

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

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

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

On March 28, 2002, the National Regulatory Authority issued Order No. 7/02/CIR: established that by November 30, 2002, the National Regulatory Authority would have determined the price of Mobile NP (per number costs) that should be equal to the one-off price that the operator receiving the customer/recipient must

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pay to the operator giving the customer/donor the price. Mobile NP would have been applied starting January 1, 2003. Per cost number should not be higher than the price applied to fixed-line services as established by Order No. 10/00/CIR at 10.02. In January 2003, The National Regulatory Authority issued a new Order No. 13/02/CIR setting a cap price for the portability charge. This charge can not be higher than the price established for Number Portability between fixed operators.

Carrier Preselection (CPS)

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

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

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

Rights of Way

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

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

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

Public Concessions

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

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

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

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

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

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

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

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

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

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

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According to Resolution 286/02/CONS, issued by the National Regulatory Authority on September 25, 2002, all TACS frequencies are to be released and returned to the government, which would then reallocate them on GSM.

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

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

Licensed Operators

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

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

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

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

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

In accordance with Presidential Decree No. 211 of August 1, 2002, the duration of all individual licenses is now 20 years (before such decree the duration was 15 years). Transition towards the third generation will be gradual with an extensive launch of the service expected in 2004.

XDSL/ATM Broadband

In December 1999, Telecom Italia received temporary authorization from the National Regulatory Authority for the wholesale offering of ADSL/ATM access service to Other Licensed Operators and Internet Service Providers. In February 2000, Telecom Italia started the always on retail offering for fast internet access. The ADSL 640 wholesale offer has been partially modified by the National Regulatory Authority with order 217/00/CONS issued in April 2000. In February 2001, the National Regulatory Authority approved the Permanent Virtual Circuit (ADSL up to 2 Mbit/s and HDSL up to 155 Mbit/s technologies) offer as presented by Telecom Italia and authorized Telecom Italia to offer XDSL retail services branded as RING and FULL BUSINESS COMPANY from April 2001. At the end of 2003, ADSL 640 and XDSL wholesale services were available in 2,120 towns for about 80% of total lines on a national basis.

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

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

Tariff and Pricing Policy

Overview

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

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

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

- services under a price-cap obligation (RPI-X): the X is differentiated according to different levels of competition in the provision of the various telecommunications services (such as installation, connection charge, local voice calls, long distance voice calls, international voice calls);

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- services under cost-orientation and accounting separation obligations: Interconnection, Special Access and Leased Lines, due to the Significant Market Power of Telecom Italia in the provision of these services; and
- services to be kept affordable, on the basis of the regulation concerning the universal service obligation.

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

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

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

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

For further details, see Item 4. Information on the Telecom Italia Group Business Units Wireline Domestic Tariff Rebalancing.

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

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

EU Telecommunications Law and Regulation

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

The 1999 Review

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

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

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

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

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

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

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

A notification will require only the following elements:

- a declaration of the intention to start operation;